Peer to Peer Visit Report

DMI visited FGDA (RITMI)
23rd September 2013

Background of the meeting and the visiting delegation:

Speaker: Jörg SCHOOLMANN
Communications officer and Assistant to the managing director Deutsches Microfinanz Institut - DMI, Germany
Since 2000 Jörg Schoolmann works with entrepreneurs and small businesses. In 2010 he has joined DMI and is involved in different national and international projects which strive to improve the develop the microfinance sector in Germany and Europe. He works as communications officer and assistant to the managing director. His main task is to support German MFIs' management and loan officers dealing with more difficult customers. Also, he is in charge of promoting best practice. He is the contact person for all German MFIs and their customers in case of complaints. Jörg Schoolmann also works for a German MFI.

Participants	**Institution**
BEVACQUA Cristian	Fondazione Un Raggio di Luce Onlus
DAGRADI Diego	Fondazione Giordano Dell'Amore
DE MICHELE Angela	Fondazione Giordano Dell'Amore
DE RUGERIIS Renata	Ass.I.Te. Onlus
DONIZZETTI Silvia	Mag Verona
FRESA Ilaria	MicroProgress Onlus
GUERINONI Romano	Fondazione Welfare Ambrosiano
NEGRO Maria Cristina	Fondazione Giordano Dell'Amore
OSTI Annibale	Banca Etica
RODRIGUEZ PULIDO Patricia	Acaf Italia
SCHOOLMANN Joerg	DMI Deutsches Mikrofinanz Institut
SCOGNAMIGLIO Elisabetta	MxIt- Microcredito per l'Italia

On September 23rd 2013 Giordano Dell'Amore Foundation organized the Peer to Peer Visit between DMI and FGDA (RITMI) and for the occasion it invited Jörg Schoolmann from the German microfinance network. The main goal of the visit was to share experiences between two different national microfinance networks, RITMI and DMI, in order to identify what of the German experience could be replicated in Italy. Specifically, DMI's representative discussed with the participants the following relevant topics:

- DMI Accreditation System;
- Services offered to members;
- Funding sources;
- DMI Risk Management System.

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Overview of the German microfinance sector

In Germany there is no specific law on microcredit provision, hence for any regular loan disbursement a banking licence is required. Due to this legal framework and to the banking monopoly, microfinance institutions have to cooperate with banks: on one hand the latter are in charge of opening a bank account, administering and disbursing the loan whereas on the other hand the former are responsible for the selection and monitoring of clients.

During the 1980s and 90s the sector consisted of small, regional initiatives supported by private funding or in cooperation with job agencies and Deutsche Bank Foundation.

A transformation started in 2004 when microfinance and government representatives as well as private investors gathered in Stuttgart: every stakeholder agreed on the necessity to develop a microfinance sector to provide loans to SMEs. A project called "5,000" was launched, aiming at disbursing 5,000 loans per year, when at the time only 200 loans were being granted: until 2010 the goal was not achieved since microfinance institutions succeeded in disbursing only 1,200 loans. Meanwhile in 2007 also the Germany's Ministry of Labour and of Economics and GLS bank joined the cause providing additional funding. In those years the house bank principle was very popular: the federal public development bank KfW Mittelstandsbank funded loans under €25,000 under different programmes via local banks and it took over up to 80% of the liability for the channelling bank. Interest rates were generally low, starting from 2.4% and a 12- or 24-grace period was granted. Banks would get a fee of €1,200 per loan, however 20% risk was too high and in the end the program was cancelled.

The real turning point was reached in 2010 when the 100 million € microcredit guarantee fund "Mikrokeditfonds Deutschland" (MKFD) was set up with government and ESF funding in order to grant microloans to microenterprises and self-employed people excluded from bank credits. The aim was to establish a nationwide-network of microcredit providers and disburse 15,000 microloans until 2015. This fund enhanced the cooperation model and greatly improved the environment for microcredit provision in Germany: loan activity steadily increased reaching 4,758 microloans disbursed in 2011. Gls Bank was selected to administer the loans. MFIs can provide a first loan up to €10,000 and further loans up to €20,000 after paying back the first loan (step lending). Interest rates are currently fixed at 8.9% and the maximum loan duration is 36 months. According to contractual terms, MFIs handle the whole credit process from the first contact with the client until full repayment and they have to cover a first-loss liability up to 20% of their overall defaults. The remaining 80% is covered by the fund so that the bank bears no risk. In case of default, once the MFI has repaid the loan, it has the right to try to recover money and get the collateral.

The fund was set up as a revolving fund and initially the ministry ensured that it would last at least until 2015 with the idea to continue to work; nevertheless in December 2012 there has been a change of policy and the contract was cancelled, while negotiations with the bank, the fund and the government on how to improve the system were going on: MKFD will stop its work by the end of 2014. This puts ahead a big challenge for the sector: MFIs have to look for other funding sources and have to set up a new fund, which is supposed to be available in 2014. DMI is currently negotiating a new guarantee fund with Triodos Bank, working as

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follows: the first loss of 20% it would be covered by European money, the following 30% would be covered by investors (cities, local ministries, etc.) and the last 50% would be on the bank. The interest is planned to be set up at 9.75% of which 4,5% would go to Triodos for opening the bank account and covering the risk, 1.5% to the fund and the rest to the MFIs.

DMI Institutional Profile

DMI was formed and registered as an association in 2004 by 50 actors differently involved in the microfinance sector (mainly participants to pilot projects) who recognized the need of a common, nationwide structure to develop further a sustainable microfinance solution in Germany. Its central mission is to develop a methodology and ensure responsible and high quality provision of microloans, which entails to: treat customers with respect, taking into considerations their real needs and assessing carefully their financial capacity so that the products offered are able to meet the needs of customers, who don't always need money, and to support their personal and financial development. DMI lives its mission on three different levels: by providing services to microfinance players, by representing interests of its member and by improving the socio-economic structures for microfinance in Germany and Europe. Its long term goal is to serve 50,000 customers annually through its members and to have a brand name in the microfinance sector: currently it serves 7,000 clients so there is still a long way to go. According to KfW estimation, there is a market since traditional banks to not like to finance small businesses.

At the moment DMI counts 73 members of which 63 are accredited MFIs, the remaining members are business consulting organisations, research centres, public bodies as well as individuals who are willing to support microfinance. Not every MFI belongs to the network: there are some institutions that work outside, there is not a law that imposes a register as it will in Italy.

DMI's governance structure is very light and it is composed of a General Assembly which meets once a year to respect legal formalities of an association and to which every member takes part; a Board (8 members) which determines the guidelines of the business policy and supervises and supports the management; the Assembly of Accredited MFIs which meets at least twice a year, depending on funding available, and which is responsible for defining MFIs' needs. DMI usually asks its General Assembly if there are any topics to tackle or any service DMI should offer; certain particular topics are discussed only at MFIs regional meetings. Moreover DMI has only two persons appointed as staff, one working full time the other part-time. DMI's office is located at the Managing Director's company, therefore there is no rental fee. Fixed costs are kept low also by the fact that the Managing Director does not get a regular salary for the time spent working for DMI and the Board of Directors are paid only €500 a year. DMI is also responsible for covering their travelling and accommodation expenses.

Product and Services

In order to fulfil its mission of ensuring a high quality, responsible provision of microcredit, DMI developed several products and services to offer to its members:

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European Commission

1. Accreditation System: MFIs soon realized the need to agree on quality standards, not only to provide a high quality service but also to attract funds from investors. With the establishment of the cooperative model and the MKFD, DMI offered to evaluate on a regular basis the quality of MFIs willing to participate to the system: in order to have access to funds provided by the system, MFIs must work in accordance to the accreditation rules developed by DMI. The minimum quality requirements set by DMI that MFIs must meet concern customer and investors relations, risk management, reporting standards, collaboration with partners of the cooperative model, personnel and adoption of the MIS developed by DMI itself. MFIs are evaluated on each quality criteria on a scale that goes from 0 (not applicable) to 4 (fully applicable): the final score is the result of a weighted sum of each criteria and quality area and an MFI passes the accreditation process if it achieves at least the 70% of the maximum score possible. DMI has been working on these rules since 2011: MFIs did not want an external party to dictate rules but wanted to set up their own, this is why a very high standard had to be achieved, so that no one could have drawn the conclusion that the self-imposed rules were not good enough. One of DMI's most important tasks is to ensure quality of the microfinance system.

2. Consulting and Training: DMI advises and trains microfinance actors, offering courses to both loan officers and to MFI management staff, as well as individual counselling. Twice a year it also organizes the so called “days of exchange”, which include both formal and informal moments during which all the MFIs gather and share experiences on how they run their own business.

3. Research and Development: DMI through ad hoc working group instituted by its members conducts hands-on research on specific topics of interest such as processing cost, market methodology, etc.

4. Representation of interest: DMI represents MFIs interests both on a national and international level, by participating in working groups, conferences, events and by negotiating regulation and resources with policy makers, funds and banks.

5. Risk Management System: DMI started working on MIS and risk management since 2004. In 2012, concerned about the fast growth experienced by some MFIs, it decided to run a pilot project with the aim of developing and testing an early risk warning system to better control dynamically developing MFIs: with this project it was nominated among the finalists of the Giordano Dell’Amore Microfinance Good Practices Europe Award 2013. DMI contracted with banks the possibility to import into its system data from MFIs’ portfolios: this would minimize the contacts between MFIs and banks and allow a better monitoring by DMI. Additionally, it also asked permission to MFIs to store their data electronically and perform regular analysis. Specifically, DMI monitors on a monthly basis two indicators:

    - PAR 15 must be below 10%. If a loan officer has a PAR 15 above 10% for two consecutive months he is not allowed to disburse loans anymore;
    - Restructured loans below 25% of the outstanding portfolio.

The MIS developed allows producing reports that can be provided externally: one can quickly extrapolate information about the number of loans disbursed, the overall volume, defaults, average loan size and this information can be segmented per costumer characteristics (age, education, marital status, immigration background), loan officer and MFI by simply applying different filters to the system. The MIS can also easily calculate the performance of each portfolio: expected payments, revenues, etc. Regarding the Risk Management System, Inthepro, its main feature is that it allows MFIs to easily stay in touch with customers and monitor them in a standardized way. At the beginning of the month an e-mail or SMS is automatically sent to the customer with three questions:

- o How are you doing?
- o How is your business going?
- o Will you be able to pay?

Customers answer with a scale from –3 to +3 and they can also leave a note to try to explain their situation and give additional information. Information is automatically stored and displayed in colours: green when everything is ok, yellow when there are some problems and red for the clients that have to be called immediately. Loan officers call immediately also customers who did not reply. This system has proved to work well with 80% of the customers: indeed there are moral hazard problems, since a customer has the incentive to lie, however a loan officer, with an average portfolio of 150-200 clients, cannot spend the whole time on the phone and this system enables to identify the most urgent calls to make. Whenever there is a problem the loan officer has to elaborate an action plan on how he is planning to help the client: likely, he will get in touch with guarantors and friends. Anyhow, about a third of customers runs into difficulties sooner or later for different reasons, but still the default rate is very low, 5%. DMI identified 5 different types of customers:

1) Customers paying on time;
2) Customers late with one quota who have a 10% probability of running into problems;
3) Customers late with more than 2 quota;
4) Customer behind the repayment schedule for more than three months and with restructured loan: real difficult one;
5) Customers who have been written-off.

DMI also tried to elaborate a formula to forecast the expected loss on the basis of the 5 types of customers which for some MFIs works well but for some it doesn't. What it wants to avoid is to develop a scoring system, which would make them reason and take decisions like a bank. Indeed they are trying to improve lending decisions and to learn from soft facts, for example how careful the customer is in filling up the application form.

<u>Funding Sources</u>

DMI needs some €200,000 a year to perform all its activities. It has several channels through which it finances its activities:

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1. Basic Membership fee: €240/year per organization, €120/year per individual which amount to approximately €17,000 and it is not enough to cover all the expenses.
2. Additional contribution of MFIs: when DMI has not enough funding it asks its members to contribute in different ways. For example, for a two day workshop, it would ask 100 euro per participant. Moreover, MFIs pay an additional monthly fee depending on the number of loans they disburse: - up to 100 loans: €75; - 100-400 loans: €150; above 400: €300.
3. Different sources: the main source of income have always been projects. DMI elaborates projects according to the needs of its members (e.g.: processing costs) or to its partners requirements (e.g.: European code of good conduct) and then seeks for funding from different sources: European Commission, public money, private investors etc.

Lessons learnt during the visit:

The main lessons that can be learned and that helped DMI become a successful network can be summed up in the following:

1. Speak with one voice: DMI soon realized the need of a strong umbrella organization to represent MFIs interests. Dispersed interests will also disperse funding. Moreover, also government representatives are more prone to talk to an umbrella organization and find it difficult to deal with many different MFIs representing their own private interest
2. Participative, Bottom-up Approach: DMI stressed how most of the initiatives come from within the network: every member has realized that its business benefits from being part of the network. DMI itself asks its members to form working groups to discuss several topics and MFIs are always willing to participate and take part.
3. Sharing: DMI creates many opportunities for MFIs to meet, stay in touch and share experiences, discuss problems, initiatives and projects: it pulls different know-how and methodology and makes it available to its members. DMI succeeded in creating a real community, a social bond which makes running the business more pleasant.
4. Centralized fund: not only interests must be centralized through an umbrella organization, but also all the funds available should be channelled into a centralized fund, which would help in standardizing business models and proving the social value microfinance has.
5. Importance of numbers: data on financial and social performance are necessary not only to attract investors, but also to test the effectiveness of the management systems developed and hence improve the business.

The visiting organisation's plans to adapt some key lessons to its own organisation:

RITMI is still at a starting point: it is highly desirable that the above mentioned lessons will be adopted and implemented.

For what concerns DMI, the main challenges lying ahead will be indeed to find new funding sources, as the MKFD will stop working and also and to start focusing on different products as microsaving and micoinsurance.

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