Enterprise publications

Microcredit for small businesses and business creation : bridging a market gap

Report

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REPORT

Microcredit for small businesses and business creation: bridging a market gap

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EXECUTIVE SUMMARY

Micro-finance for new or existing small companies was recognised as an issue by several EU Councils of Ministers in 2000 and taken into account in the European Multiannual Programme for Enterprise and Entrepreneurship (MAP), in particular SMEs (2001-2005), adopted by the Council in December 2000 with the creation of a microcredit guarantee window. Microcredit to small enterprises is defined there as a loan below € 25,000: for the purposes of the microcredit report, the same definition is applied. In March 2003, the European Council urged, for the first time, the Member States to pay special attention to microcredit in order to encourage small enterprises to get started and grow.

This microcredit report was prepared for the Enterprise Policy Group (EPG)[1]. This report deals mainly with access to finance for small entrepreneurs and describes their relationship with public or private banks, private micro-finance providers, guarantee societies and business support services.

This report was drafted by Enterprise Directorate General of the European Commission and is based on the main findings of a working group composed of 26 national experts from EU-15 Member States and Candidate Countries and several micro-finance practitioners who met seven times between July 2002 and July 2003. It is based on a sample of some € 3.5 billion of microcredit provided to small enterprises in 2001.

Small enterprises, new or existing, often face certain problems when they approach finance providers for both enterprise fixed capital investment and working capital. This insufficient supply of microloans is a major issue, particularly where business creators are unemployed persons, women or form part of ethnic minorities. Supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also of social inclusion.

As banks often perceive microcredit as a high risk and low return activity due to the important failure rate and the high handling cost for microloans, there is a market gap based on information asymmetry, in particular in the Candidate Countries. This market gap has been confirmed by several Pan-European surveys on small enterprises.

In order to bridge this market gap, at least partially, public support is available in all Member States and the majority of Candidate Countries. However, the scope and intensity differ considerably between countries. Public support can be offered through an enabling environment and tax incentives for investors supplying funds to microcredit retailers. Public support can also be offered by providing funds to specialised lenders, by sharing part of the risk with specialised guarantee societies and/or by promoting business support services.

At the national level, against the need for public support to microcredit, public promotional banks, where existing, play an active role and remain an efficient and effective vehicle to provide partial credit and/or guarantee, in particular where large-scale operations are required.

In addition, guarantee (co- and counter-guarantee) schemes make it easier for the credit institution to provide microcredit because its risk exposure is reduced and its capital requirement mitigated. As a complementary guarantee scheme, the MAP microcredit guarantee window, managed by the European Investment Fund, is considered efficient and effective to enable financial institutions to increase their microcredit exposure.

At local level, since the 19th century, savings banks and co-operative banks have been the main micro-credit providers. The microcredit provided by banks however is often not

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[1] The EPG is a group consisting of experts from the Member States and advising Enterprise Directorate General on enterprise policy.

sufficient to match the demand. In last two decades, therefore, new private microcredit institutions have been emerging, subject to different legal forms and primarily serving social inclusion purposes.

Among the lessons learned from recent experiences, the report examines the following:

- In addressing the market gap for credit to small enterprises, the financial instruments managed by EIF under the Growth and Employment Initiative (1998-2000) and the MAP (2001-2005) are considered efficient and effective. The budget of MAP financial instruments should, therefore, be increased and the national financial intermediaries encouraged to promote microcredit activities based on good practices, in particular in the Candidate Countries.
- In addition to microloans, the provision of non-financial services, in particular mentoring, is essential to increase the chance of survival of start-ups and small enterprises.
- The Member States should develop a more microcredit friendly environment and, where appropriate, assess the impact of usury rate for any type of enterprise.
- The self-sustainability of the microcredit activity is a major aim: the public support should be adapted to this aim and be assessed regularly.
- A soft loan approach in force in several Member States denies private microcredit institutions the possibility to become sustainable and therefore independent of public subsidies. In this regard, the usury rate ceiling enforced in some Member States impedes financial institutions from providing micro-finance to more risky business creators and could be considered as a barrier to entrepreneurship and the search for self-sustainability of the private microcredit activity.
- Microcredit institutions are encouraged to evaluate and disclose their performance, as well as develop effective synergies with business support services. They should also adopt appropriate ex ante and ex post risk management procedures and should exchange views on the quality of the credit decisions and the adequacy of reserving policies.

1 INTRODUCTION

1.1 Aim of the report

Micro-finance for new or young enterprises is of major importance for the renewal and growth of the business population and hence to the strengthening of entrepreneurship in Member States and Candidate Countries. This issue was raised by the Union in an informal ECOFIN meeting in November 2000 and recognised by the Industry Council in December 2000.

This orientation was translated into action by including the issue into the microcredit guarantee window in the Multiannual Programme (MAP) for enterprise and entrepreneurship, in particular SMEs (2001-2005), where microcredit is described as an area where the market gap should be remedied by encouraging financial institutions to play a greater role[2]. In this context, microcredit was defined as a loan below € 25,000.

The issue of small and microloans was also discussed by the 3rd Round Table of Bankers and SMEs[3]. The Round Table was established to help improve the relationship between Financial Institutions and SMEs. It discussed several best practices in the Member States but did not succeed in agreeing on a common definition for microloans. In its recommendation to the EU, the Round Table requested an expansion of EU guarantee facilities to small loans.

In its meeting of 20 and 21 March 2003, the European Council highlighted the importance of promoting entrepreneurship through an action plan and measures to improve access to finance, and for the first time, stressed the importance of microcredit.

In this regard, this issue is even more important for Candidate Countries, where the level of domestic credit provision is a matter of concern. There is a need to find common solutions to common problems and share best practice and experience across the Union and Candidate Countries. This is particularly relevant for the access to micro-finance by small enterprises.

1.1.1 Micro-enterprises in the EU and Candidate Countries

Access to finance is particularly difficult for business creators but less difficult for existing small enterprises with a track record[4]. According to a pan-European enquiry on existing SMEs[5], access to finance is still perceived as a business constraint by SMEs, and even more so by micro-enterprises than by medium-sized enterprises. The majority of existing and new businesses are very small. According to a recent survey[6], 93% of the 20.5 million[7] European SMEs are micro-enterprises (0 to 9 employees). Most of these micro-enterprises are self-employed people who do not create additional jobs, do not have the resources or do not want to grow. Those micro-enterprises wishing to grow, however, often do not have access to the necessary external financing.

Every year, some 2 million enterprises are created, 90% of which are micro-enterprises with fewer than 5 employees.

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[2] Council decision 2000/819/EC of 20 December 2000

[3] Enterprise Directorate General; Third round table of bankers and SMEs; 19/06/2000.

[4] Access to entreprise's finance, Commission staff working paper, SEC (2001) 1667, 19/10/2001.

[5] Grant Thornton, European Business Survey, 2002.

[6] ENSR survey; 19 European countries, questionnaire to 7 662 SME; August 2001.

[7] 22 million if Candidate Countries are included.

In the EU, some 30% of new enterprises do not survive more than 3 years after their creation and some 50% less than 5 years. The failure rate is lower in those Member States where high quality support services - including those facilitating access to finance - are available to accompany entrepreneurs before and after they create their business or to assist existing small enterprises. These quality support services are usually based on public-private partnerships, with a varying degree of public support.

1.1.2 Loan finance in the EU

Europe has a long tradition of loan finance, which remains the main source of external finance for small enterprises. Equity finance, which is less developed than in the USA, is not considered to be the solution, indeed not even an option, by the majority of European small enterprises. For those enterprises with growth potential, however, some form of risk finance may be the most appropriate way to facilitate early growth.

Access to loans by new and small enterprises is very different in the Member States and Candidate Countries. Where SME promotional development banks or national risk-sharing schemes are available, access to small loans appears to be easier. The number of SMEs and new enterprises reached by these schemes however, varies considerably.

A "North-South gap" can be observed in the EU: traditionally, access to debt finance by small enterprises seems easier in northern countries than in southern ones. In addition, an "East-West gap" has also become increasingly visible due to the fact that domestic credit as a percentage of GDP is much higher in the EU than in the majority of Candidate Countries where the banking sector is still recent: this feature is one of the reasons for the strong development of non-banks providing microcredit in the Candidate Countries.

Microcredit provision is a difficult activity because of the perceived high risk of failure and the high handling costs. Some credit institutions do so though, either because it is part of their mission to accept low returns; the risk is partially taken by a public guarantee institution or a mutual guarantee society; or, to a lesser extent, it may be a marketing strategy to support enterprise creators, who could later become good clients.

Outside of public-private schemes, credit institutions are often reluctant to offer loans to enterprise creators. If they do so, they normally offer credit lines or overdrafts (with substantially higher interest rates) rather than short or medium term loans (with normal interest rates). Credit lines represent a much higher risk for entrepreneurs, as they are more expensive and can be recalled at any moment by the credit institution. For this reason, small entrepreneurs would prefer the better contractual stability provided by short or long-term loans.

When offering a loan, credit institutions ask for collateral, usually a personal guarantee or a mortgage on real estate. The collateral requirement for microloans often exceeds the amount of the loan (up to 150% in certain countries).

As banks were not able to bridge the gap in the provision of microcredit, in some Member States and Candidate Countries, non-banks emerged, in the form of limited liability companies, trusts, charities or other forms of associations to fill this market gap.

The specific objective of the report is to give an overview of existing good practices concerning microcredit (<€ 25,000), as well as associated guarantee schemes, to new and existing small enterprises in the Member States and Candidate Countries. To allow for a consistent assessment across Member States and CCs, a questionnaire has been drawn up, based on the main areas identified by the working group.

1.2 The report structure

This report prepared by the Enterprise Directorate General refers mainly to access to finance by small enterprises and describes their relationship with public or private banks, private micro-finance providers, guarantee societies and business support services. The main findings of the microcredit report will be integrated into the "Access to Finance Report" due to be presented to the Industry Council in the last quarter of 2003.

The Microcredit Report has been drafted by the Enterprise Directorate General of the European Commission is based on main findings of the working group composed of 26 national experts from Member States and Candidate Countries and several micro-finance practitioners who met seven times between July 2002 and July 2003. It is based on a sample of some € 3.5 billion of microcredit provided in 2001.

The report is structured as follows:

Chapter 2 outlines the microcredit background and actors;
Chapter 3 looks at business support services;
Chapter 4 selects lessons learned on microcredit product designing;
Chapter 5 describes the recent developments in microcredit supply;
Chapter 6 reviews some risk assessing, scoring and awarding decision features;
Chapter 7 outlines the impact of microcredit on SMEs;
Chapter 8 sets out the microcredit performance assessment;
Chapter 9 contains conclusions and recommendations.

The target audiences of this report are those responsible for or dealing with microcredit in the Member States and Candidate Countries and decision-makers involved in economic policy.

2 BACKGROUND AND ACTORS

2.1 A market gap

Over the last decade, in particular at the end of the nineties, small enterprise's access to finance has gradually become a higher priority for Member States policy-makers, finance providers and enterprise organisations in the EU.

The banking sector is undergoing major adjustments due to the merger dynamics, the search for profitability and the economic downturn[8], which might have an impact on their relationship with small entrepreneurs. The closure of local branches by many banks across Europe might also have an impact on banks' ability to get accurate information about local small businesses.

Micro-enterprises, new or existing, have problems when they approach finance providers both for working capital and investment to fund specific projects.

[8] According to European Central Bank, "the results of the April 2003 bank lending survey indicate a continued net tightening of credit standards over the past three months. (…). Expectations regarding general economic activity were the most important contributing factor (…)." See more on: www.ecb.int

Usually, it is considered that in a "perfect market" situation, where all information is available for both parties, a finance gap would not appear.

The real situation is however quite different: markets are characterised by market imperfections, inter alia due to information asymmetry. For the loan provider, the information regarding the quality of the business and its management is difficult to get and very expensive. The lack of information may lead the credit institution to adverse selection[9]. Due to such information asymmetries, a specific market gap for micro-credit has arisen. In certain Member States, as much as 78% of new enterprises do not receive any bank loan[10].

In a recent survey, access to finance remains a major constraint for 20% of SMEs[11]. Several obstacles are generally mentioned. Ranked by importance, they are the following:

- **high handling (or operational) costs** for credit institutions[12]. The handling costs for the microcredit provider are high if compared to the small size of loans. In this regard, the best estimates (€) by country found by the Microcredit Working Group, were the following:

Microcredit providers handling costs best estimates (€) by country

United Kingdom	Germany	Finland	Sweden	Czech Rep	Estonia	Poland	Ireland	Latvia
1,335[14]	1,100	700-1,000	700	600-900	590[15]	200-330[16]	170[17]	135

The wide variation of reported handling costs for the lender depends mainly on four aspects and the varying amount of time awarded to each one:

- support to the preparation of an enterprise loan application, reflecting the level of "investment readiness" of the borrower;
- internal process to secure the credit deal, including the assessment and approval costs, identification of collateral as well as back office costs;
- internal loan monitoring, including late payment and default procedures;
- non-financial business support and mentoring, which is the largest single operating cost in certain cases.

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9 Stiglitz and Weiss (1981) "Credit rationing in markets with imperfect information", The American Economic Review, Vol.71, pp 393-410. Tucker and Lean (2003), "Small firm finance and public policy", Journal of Small Business and Enterprise Development, Vol.10, pp.50-61; Altman I. (1968) "Financial ratios, discriminant analysis and the prediction of corporate bankruptcy", Journal of Finance, Vol.23, n°4, pp.589-609.

10 Observatoire Agence pour la Création d'Entreprise, www.apce.com.

11 Grant Thornton, European Business Survey, 2002.

12 Micro-lending, a case for regulation, id, p.20, footnote 16: € 1,500. This estimation refers to Savings Banks in Germany.

13 For the Italian CONFIDI guarantee scheme, handling costs are estimated at € 150 p.a. and the loan maturity is in average 43 months: therefore, total handling costs are in average: € 540, without taking into account bank's handling costs. For a guarantee provided by AWS (Austria), the handling costs are on average € 300.

14 Source: Survey of UK micro-lenders for loans below € 30,000 conducted by the Community Development Finance Association (CDFA), 2003. The range is between € 835 and 2,255.

15 The number represents the handling costs of a microloan guarantee application in KredEx.

16 Cost using simplified procedures for microcredit.

17 Best estimate for First Step interest-free loans.

Compared with the average microcredit amount, the percentage of handling costs is the following:

Percentage of handling costs in relation to the microcredit amount (%) by country

United Kingdom	Germany	Finland	Sweden	Czech Rep	Estonia	Poland	Ireland	Latvia
From 6[18]	7.3	4.6/5.4	7.5	2.1/3.2	4,4	6.7/11	3	4

- **lack of sufficient collateral** from the micro-enterprises, and;
- **high risk:** even if the reasons are not always clear, microcredit is considered a risky business by finance providers. On average, 50% of EU new businesses are disappearing before 5 years, with a spread among Member States from 40 to 60%, depending on the intensity and the quality of business support services. The disappearance (or non survival) rate can however drop to 5-7%[19], in the case of enterprises receiving bank loans, guarantees and mentoring services.

In addition, the limited gross profitability margin of microcredit activities (even below 1%[20]) and the small margin of manoeuvre for cross-subsidies between bank products would lead the banks to be less willing to provide microcredit, except if they consider the microcredit to be the start of a long-term business relationship with a dynamic entrepreneur capable of developing the business.

Moreover, in certain countries, a compulsory threshold for the interest rate (usury rate) denies the possibility for credit providers to cover all risks incurred. Consequently, this threshold denies the emergence of a sustainable and steady flow of microcredit to small enterprises.

Public subsidies are however often used to share the risks through counter-guarantees and cover at least part of the handling costs.

2.2 Scope and definitions

The report does encompass main finance activities known as “microcredit” in a broader sense. In line with the MAP, it is focusing on loans below € 25,000, as well as associated guarantee schemes, to new and existing micro-enterprises[21]. The report primarily considers microcredit in the context of enterprise policy, but also recognises the role that such finance plays in encouraging enterprise as an element of social inclusion policy.

The report was initially meant to focus on micro-enterprises with growth, survival and job creation prospects.

It was decided, however, that it was relevant to go beyond the scope initially agreed to take into account all business creators, including unemployed persons, as well as to partly cover, on the one hand, some substantial activities carried out by non-banks, in particular, by limited liability companies, and, on the other hand, to analyse the NGOs which deliver microcredit programmes primarily from a social inclusion perspective[22]:

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18 Source: Survey of UK micro-lenders below € 30,000 by CDFA, 2003. Transaction costs vary between 6% and 35%.

19 As it is, for example, the case for craftsmen in Germany.

20 Calculated lending margin of some major microcredit programmes: 0,90% for KfW with Startgeld; 1% for FINNVERA microloans to women; 1,7% for BDPME with the PCE.

21 EC recommendation concerning the definition of micro, small and medium-sized enterprises, C(2003) 1422 of 6 May 2003, replacing 96/280/EC.

22 *“Lettre ouverte…”*, Jean-Paul Vigier, Editions.Charles Léopold Mayer, Paris, 2003, p. 150.

- Most microcredit operations generally involve public banks, either acting as finance providers to institutional customers or providing finance directly to small enterprises. Their legal framework is the European banking directive[23] and national legislation on credit institutions. Credit institutions, commonly called banks, shall mean an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credit for its own account. However, deposit taking, credit extension and guarantee activities fall under the supervision of different public entities (e.g. respectively under Financial Services, Fair Trading and Insurance legislation in the United Kingdom).
- In addition, in eight Member States, there are also state-owned promotional banks which are either under public supervision or receive specific treatment[24], for, in particular, the function of finance provider for institutional customers[25] in charge of the direct contact with micro-enterprises.
- In some countries, microcredits to small enterprises are awarded by micro-finance institutions under Civil Code, which are generally compliant with the Directive on Consumer Credit. As for credit institutions, these micro-finance institutions are commercially driven and following a sustainable business model.
- Microcredits provided by NGOs primarily for social inclusion purposes[26] are also significant in some Member States (France, United Kingdom) and Candidate Countries: here they contribute to the promotion of enterprise as a tool to fight social exclusion and unemployment[27]. Depending on national legislation and traditions, their legal framework is diverse: non-profit associations (France), charities, not-for-profit companies (United Kingdom).

In addition to the microloan providers, the report will also look at important associated players:

- Guarantees schemes are also major microcredit facilitators, including mutual guarantee schemes.
- Business support institutions provide non-financial services (mentoring, training…).

Personal or consumer loans, as opposed to credit to enterprise, are not considered in this exercise, despite the fact that often operations registered as personal loans are in fact microloans to micro-enterprises and self-employed entrepreneurs (e.g. Credit Unions of Ireland, Poland…). No genuine statistics on such lending are available apart from statements made in recent publications[28]. In general, as the majority of microcredit borrowers are self-employed entrepreneurs, it remains difficult to distinguish whether the loan awarded qualifies for a microloan to the micro-enterprise or a personal loan.

Microcredit activities outside the EU[29] and Candidate Countries[30] are beyond the scope of the report. Although, the Phare SMEs finance facility has a threshold for individual loans of € 125,000, well in excess of € 25,000, it is partly taken into account in this report because the average loan amount is around € 22,000.

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23 2000/12/EC of 20 March 2000, OJ L 126 26 May 2000.

24 For example, FINNVERA has a permanent exclusion from the banking legislation.

25 Some promotional banks provide financing directly to micro-enterprises: Finnvera, Fonds de Participation, etc.

26 Promotional banks, such as Fonds de Participation and ICO, have also products with specific social inclusion purposes.

27 Legal and political conditions for credit extension for social purposes by non-banks in the EU-Analysis; Final Study Part 1, P. 65, by IFF Hamburg, DG Employment and Social Affairs, European Commission.

28 Micro-lending, a case for regulation, Pr Udo Reifner (IFI), p.199, NOMOS, Germany 2002, 394 pages.

29 Communication from the Commission on "microfinance and poverty reduction", May 1998, COM(98)527.

30 See www.cgap.org.

2.3 European incentives

At the European level, two main financial programmes for SMEs have been active in the last 5 years. Since 1998, the Community has been providing counter-guarantees for SME lending.

EIF guarantee schemes, www.eif.org

The activities carried out in the framework of the Growth and Employment initiative (1998-2000) benefited 120,000 SMEs.

Since June 2002, a SME guarantee facility, with a specific window for microcredit guarantee, has been available within the Multiannual Programme (MAP) for the promotion of entrepreneurship and enterprise, in particular SMEs (2001-2005). As of March 2003, five microcredit institutions already signed an agreement with EIF: ADIE (France), Fonds de Participation (Belgium), ICO (Spain), KfW (Germany), Prince's Trust (United Kingdom).

Since 2003, the MAP has been opened to Candidate Countries, after the signature of a Memorandum of Understanding with the European Commission. The window for microcredit guarantee, aiming at encouraging financial institutions to play a greater role in microcredit, is managed by the EIF.

In addition, as part of the enlargement process, Phare SMEs Finance Facility has been the most important programme to promote access to finance to SMEs in the Candidate Countries.

Phare SMEs Finance Facility

The Facility's objective is to encourage financial intermediaries, i.e. banks, leasing companies or investment funds in the Candidate Countries to expand and sustain their financing operations to SMEs.

In order to help financial intermediaries overcome their lack of experience and to cover the specific administrative costs and risks involved, the Facility provides them with access to finance with specific incentives: technical assistance and performance fee. The Facility has been co-financed by International Financial Institutions (IFIs) namely the European Bank for Reconstruction and Development (EBRD) since 1999, the Council of Europe Development Bank (CEB) in co-operation with Kreditanstalt für Wiederaufbau (KfW) since 2000 and the European Investment Bank (EIB) since 2001.

The Facility projects are set up under two Windows: the Loan, Guarantee and Leasing Window (LGLW) and the Equity Window (EW), and take the form of loan or equity finance for local financial intermediaries, combined with tailored packages of non reimbursable financial incentives. The financial intermediaries on-lend or lease to individual micro-enterprises or SMEs, or provide them with equity capital. In certain cases, the financial intermediaries also channel additional funds from their own resources to the recipient businesses.

2.4 Nation-wide microcredit programmes

Microcredit is generally considered to be a tool to boost start-ups creation and promote entrepreneurship[31]: over the last decade, Member States have been encouraging microcredit provision by financial institutions. Member State governments can intervene by offering an enabling environment in which microcredit can operate, by providing direct financial support and/or adopting appropriate rules on social protection for micro-enterprises, in particular for start-ups. Similarly, some of the schemes subsequently described are in the form of direct financial support and others are part of a wider enabling environment.

[31] *Green Paper on entrepreneurship*, COM (2003)27, 21 Jan.2003.

2.4.1 National schemes

Depending on the national traditions and practices, several national schemes have been implemented in the last ten years. ALMI of Sweden (microloans) and Fonds de Participation of Belgium[32] (subordinated loans) began their current microcredit activity in 1992, followed by ICO of Spain (SME loans) in 1995 and Finnvera of Finland in 1996-97 (microloans; loans to women entrepreneurs).

Between 1998 and 2000, other Member States, such as France, Germany and the United Kingdom, have also adopted measures. The national schemes often have common features: national measures to promote the availability of funding to institutional customers; a retail operator, to extend the credit to the micro-enterprises. In this period, several schemes have been launched: partial credit provision; partial risk sharing; tax incentive.

The national schemes take into account the fact that a national finance provider is generally less well placed to establish effective business relationships with micro-enterprises than locally or regionally-based finance providers. Where a state-owned promotional bank exists for microcredit, activities (Austria, Belgium, Finland[33], France, Germany, Italy, Luxembourg, Spain, and Sweden), it is the finance provider of the system and local banks that are the retailers to small enterprises.

These schemes have the advantage that both, promotional banks and private banks, are under public control or banking supervision. The risk of mismanagement and irregularities is therefore limited. In addition, the operations are subject to EU State Aid and competition rules.

The recently implemented schemes are large-scale operations with an important impact on enterprise creation.

Finland: FINNVERA small loans and women microcredits[34], www.finnvera.fi

In 2001, Finnvera figures for small loans and microcredits for women corresponded to 12% of the number of start-ups per year (absolute figure): almost half of them are resulting from microcredits to women.

In addition to the loan, Finnvera offers also guarantees, if the collateral provided by the borrower is not considered sufficient.

France: *Prêt à la Création d'Entreprise* (PCE) of BDPME, www.bdpme.fr

In 2001, with 11,000 microloans, the "Get your Business Started Loan" PCE corresponded to 7% of the number of start-ups. At the beginning of 2003, the monthly average reached 1,500 PCE or an annual average of 18,000 PCE corresponding to 10% of French start-ups number.

All transactions between BDPME and credit retailers are managed through an Extranet.

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32 Fonds de Participation (FdP) was created in 1984. Since July 1992, by law, it has been an autonomous body with a break-even strategy. The 1992 law describes the products, including the interest rates to be applied to unemployed persons. FdP can offer loans directly to the final borrower (www.fonds.org).

33 FINNVERA of Finland is also a specific case. For microcredit operations, it lends directly to the borrower. It is only in the case of risk-sharing schemes where a local bank is involved.

34 See in annex, the table comparing BDPME, Finnvera and KfW microfinance programmes.

Spain: ICO SME programme, www.ico.es

During the last 7 years, ICO provided an average of € 120 million p.a. of microcredit (below € 25,000) to micro-enterprises.

Special attention has been paid to quickness in decision-making or even to giving decision autonomy to retailers. Avoiding unnecessary delays is a major concern for micro-enterprises and a factor in their competitiveness.

France: Prêt à la Création d'Entreprise (PCE) of BDPME

Regarding the PCE of BDPME, launched in 2000, under an agreement signed by BDPME and each retailer, the latter makes the decision of awarding a microloan: BDPME registers the microloan, automatically awards part of the microloan amount and provides a maximum of € 8,000 (on average € 6,500) where the local retailer is awarding the double, therefore € 16,000.

In addition, a 70% guarantee is issued through a subsidiary (Sofaris) for the complementary part of the loan provided by the retailer with its resources to the business creator.

Germany: Mikro-Darlehen[35], www.kfw.de

For its new product launched in 2002, *Mikro-Darlehen*, a one-page application is received by KfW through a local bank, which could be any bank in Germany. KfW then gives its decision within three days, without taking into account the period needed by the retailer to make its credit assessment.

In addition, KfW provides guarantee up to 80% on the loan amount to the local bank.

With the previously launched product, *Startgeld*, the borrowers' survival rate is 93% after 3 years. The product has been extended to an annual average of 7,000 since 1999. Its operational sustainability ratio is 100%[36].

In Candidate Countries, under the PHARE SMEs finance facility , EBRD, CEB-KfW and EIB are the finance providers to institutional customers and national credit institutions are providing loans to SMEs.

Regarding the enabling environment to promote microcredit, the United Kingdom offers an interesting scheme of tax incentive.

This incentive is not a direct financial intervention by the national government, but a part of the national enabling environment to promote the provision of microcredit to disadvantaged communities by increasing the supply of funds for the microcredit retailers.

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35 Deutsche Ausgleichsbank (DtA) launched two microcredit products DtA-StartGeld and DtA-Mikro-Darlehen in 1999 and 2002. In July 2003, DtA merged with KfW and is now part of KfW Group. Both products remain unchanged. DtA-Startgeld became Startgeld and DtA Mikro-Darlehen became Mikro-Darlehen.

36 OS= revenues from customers / (administrative costs + losses + refinancing costs).

37 The maximum amount threshold for a loan is €250,000. A significant part of the operations are however below €25,000. The incentive (performance fee) is specially designed to promote small amount loans.

United Kingdom: tax incentive

The UK's Community Tax Relief (CITR), implemented in 2003, provides an incentive to investors providing patient capital to specialist micro-finance institutions known as Community Development Finance Institutions (CDFIs). An individual or corporate investor willing to provide capital to a CDFI either as a loan or as share capital for at least five years will receive a tax relief of 5% of the amount invested in each of five successive tax years. CDFIs, which must be accredited by the UK government's Small Business Service[38] to attract this investment, then lend to start-ups, existing enterprises and community projects. CITR has been cleared by the Commission as a compatible State Aid.[39] As of July 2003, 20 CDFIs have been accredited and between them these institutions intend to raise € 120 million from investors for on-lending over the next three years.

2.4.2 National and regional guarantee schemes

Micro-enterprises are perceived as very risky by a credit provider and very often, the micro-entrepreneur has no suitable collateral to offer. A way of sharing the risk is to ensure the participation of either a public, private or mutual guarantee scheme. Guarantee schemes are not generally exclusively targeting microcredit or small entrepreneurs: depending on their individual features, they are open to SMEs in general, to a specific economic sector, to a certain area or to members only in the case of mutual societies.

Important guarantee schemes are available in several Member States (Austria, Belgium, Denmark, Finland, France, Germany, Italy, Portugal, Spain, The Netherlands, United Kingdom). They share the risk with the microloan provider. Some Candidate Countries have also created a national or regional guarantee scheme (Czech Republic, Estonia, Hungary, Poland, Romania, Slovakia and Slovenia).

Estonia: Credit and Export Guarantee Fund, KredEx, www.kredex.ee

KredEx supports the growth and development of SMEs by improving their access to finance through guarantees for credit arrangements between companies and their banks. The loan application is submitted directly to a bank. If the bank is prepared to grant the loan contract subject to the agreement of Kredex to provide a guarantee, then the bank forwards the application to Kredex. The scheme is focused on cases which without the guarantee, would be appraised negatively by the banks. The guarantee covers up to 75% of the outstanding loans. So there will always be a risk for the banks of a minimum of 25% to 40% of the outstanding debt. The loan guarantee scheme has been in place since March 2001. Kredex also runs a risk, which is reflected by the fact that there is a guarantee fee of 1.5-3% of the loan. This means that, although the scheme is intended for higher-risk activities and also projects, Kredex will see to it that the risk is within limits, regardless of the potential value of the particular project.

In 2002, for the period up to August, Kredex received 174 applications, which amounts to around 260 applications on an annual basis. Around a quarter of the applications have been rejected by Kredex. It has supported SMEs lending through an amount of € 38.6 million (the guaranteed part of which is € 17 million). Each € guaranteed by Kredex allowed 8 € to be lent.

In addition to national guarantee schemes, Mutual Guarantee Societies (MGS)[40] play a major role in micro-finance.

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[38] See www.sbs.gov.uk/finance/citr

[39] State Aid N711/2001 United Kingdom "Community Investment Tax Credit" C(2002)3575 fin, Oct.2002.

[40] AECM, microcredits, August 2002; www.aecm.be

Typically, a MGS is a private society or organisation created by owners of small enterprises. When they are in charge of assessing a guarantee application or even the loan application before the bank, they offer a unique service: the knowledge of the economic sub-sector at local level, the precise technical skills required for the applicant and a detailed estimation of revenue prospects. They generally use qualitative methods for their application assessment. A guarantee provided by a MGS will drastically reduce the risk for the credit institution, which will therefore provide a loan more easily, and could even provide a lower interest rate to a micro-entrepreneur backed by a MGS.

MGS are quite important because they are particularly complementary to banks by providing data on applicants based on deep local market knowledge thereby fighting the information asymmetry. They also reduce the risk of adverse selection and provide a guarantee from members' funds and/or public funding, as guarantee, co-guarantee or counter-guarantee.

Italy: CONFIDI

Italy has a nationwide mutual guarantee scheme for the craft sector as well as industrial and commercial micro-enterprises: CONFIDI. The CONFIDI system includes 680 private companies (each with its own legal and administrative autonomy), where almost 1,000,000 entrepreneurs are members. According to the Fedart Report for 2001, the CONFIDI system facilitated the access to finance of SMEs for a total amount of € 4.3 billion and a loan amount average of € 37,800 through 113,000 operations.

As regards microcredit in 2001, 90,000 operations were below € 25,000, which gives in 2001 a total amount of microcredit reaching € 1.5 billion. For each € guaranteed by the CONFIDI scheme, the multiplier effect is from 10 up of awarded loan, depending on the individual CONFIDI involved.

Each credit assessment is made by a local CONFIDI. The past results are excellent: 1.6% of default rate, instead of 8% for the craft sector in general.

When a CONFIDI credit assessment is positive, the loan application is transmitted to the bank with a CONFIDI financial deposit of 50% of the loan amount (the remaining 50% are covered by collateral provided by the micro-entrepreneur, generally a real estate mortgage). In this 50%, there is a mix of some 10% coming from the members' fees paid to the CONFIDI and 40% coming from public (often regional) budget. In the framework of a specific agreement ("convenzione") negotiated by each CONFIDI and each bank (establishing the amount of operations, type of financial product, interest rate and other terms and conditions), the bank will apply to the loan a favourable interest rate corresponding to a lower default risk of an application directed by a CONFIDI.

In certain cases, the credit assessment is made by volunteers (without remuneration) selected by the MGS from amongst local small entrepreneurs.

France: SOCAMA, www.socama.com

Created in 1917 by a specific legislation, SOCAMA is a MGS scheme related to the Banques Populaires. In 2002, it provided guarantees to 25,000 micro-enterprises for a total of € 500 million. Net losses in % of outstanding portfolio are 1% and the average loan guaranteed € 21,000. In this scheme, the cost of the guarantee is very low: SOCAMA members, who are experienced small entrepreneurs themselves, make the guarantee application assessment by participating in the Credit Committee as volunteers. This system does not receive public financial support, except from EIF acting as a counter-guarantor. For an amount below € 25,000, the decision is delegated to the Credit Committee, resulting in a quick process ("Prêt Express").

Another important national guarantee scheme is the Spanish one. Regionally-based MGS provide a guarantee and a counter-guarantee is provided by a state-owned company (CERSA).

Spain: CESGAR (www.cesgar.es) and CERSA (www.reafianzamiento.es)

21 regional MGS, represented at national level by CESGAR, have been active in Spain for 25 years. In 2002, they guaranteed an amount of around € 1 billion of generally long-term loans to 27,000 micro-enterprises (<10 employees). The MGS administrative costs per file are estimated at € 171. These MGS are supported by a national state-owned counter-guarantee society: Compañía Española de Reafianzamiento, CERSA. Part of CERSA's activities are counter-guaranteed by the EIF.

In the above-mentioned practices, the guarantee fee paid by the entrepreneur is a fixed percentage of the loan amount. Recently, there was a reflection in order to introduce a risk-reward relationship between the guarantor and the entrepreneur through a success-based approach. The advantage for the entrepreneur arises from the fact that part of the guarantee fee is variable and to be paid when and if the enterprise is generating a return. In particular, the entrepreneur will pay less at the beginning of the guarantee term. The concept is interesting but its profitability remains to be established.

Austria : AWS GmbH, success based loan guarantee fund (SBGF)

Basis structure:
There is always a fixed guarantee fee percentage of the guaranteed loan amount (0.5%).
In addition, there is a choice between two types of success based fee:

- Either a success based guarantee fee as a percentage (0.5%) of the outstanding guaranteed loan amount, when the enterprise is generating a profit in a particular year of the guarantee term, or;
- a success based guarantee fee as a percentage of the profit generated by the enterprise in a particular year of the guarantee term.

Premature termination of the guarantee
SBGF becomes a fixed guarantee fee, with two possibilities:

- if charged as a percentage of the outstanding guarantee loan amount, the total amount of the guarantee fee for the remaining term of the guarantee is to be paid at the termination;
- if charged as a percentage of the profit, instead of the profit-share, a fixed percentage of the guarantee loan is charged for the remaining term of the guarantee.

Income from SBGF
SBGF for loan guarantees, not only to small enterprises, have been provided since 2001.
There is an increase in numbers contracted SBGF:

- 2001: 1% of total number of projects, 3% of guarantee volume;
- 2002: 4% of total number of projects, 12% of guarantee volume.

As of 2003 Q 2, it is too premature to draw conclusions: so far, there is no significant income from SBGF.

2.5 Traditional and new microcredit institutions

2.5.1 Savings banks and co-operative banks in the EU

As such, the access to finance by micro-enterprises is not a new phenomenon. Savings banks and co-operative banks have been partly created and developed in the 19th century to facilitate access to finance such as microcredit.

Savings Banks and Co-operative Banks

Savings Banks[41] and Co-operative Banks, such as Banques Populaires in France or Caixa Catalunya in Spain, remain probably the main traditional operators in the field of microcredit. To take an example, the German non profit-oriented, public sector-owned retail savings banks, Sparkassen, private co-operative banks ("Volks- und Raiffeisenbanken") account for more than half of the loans to SMEs and two thirds of customer deposits.

For the purposes of the report, however, the insufficient data make it difficult to establishing the respective share of personal loans and credit to enterprises.

A small number of Credit Unions[42] in the United Kingdom operate specific programmes for members who are seeking business finance (e.g. Northern Oak Credit Union in Newcastle, Enterprise Credit Union in London).

In France and Spain, Savings Banks[43] and Co-operative Banks have partnerships with non-profit organisations, acting as business support service providers and directing customers to these credit institutions.

2.5.2 Recent initiatives in Candidate Countries

Credit Unions are also active in the Candidate Countries: for example in Poland, 900 credit unions are currently active (1,500 in 1995). In the Candidate Countries, the credit extension to SMEs is however still a recent activity.

The amount of loans compared to GDP is far lower than in the EU – 15 Member States[44]. The overall supply of loans is quite low, except in Malta and Cyprus, because banks are often reluctant to offer loans except with high interest rates and collateral sometimes higher than the loan amount.

Consequently, some Central European micro-finance institutions are very active in this market segment.[45]

Microfinance Banks

ProCredit Bank[46], Bulgaria, was founded in 2001 by IFC, EBRD, DEG-KfW Group, Commerzbank AG and IMI AG to provide credit and general banking services to entrepreneurs and businesses throughout Bulgaria.

As of December 2002, it had awarded more than 5,000 microloans, with an average of € 5,400 per loan. 60% of the loans are secured with mortgages as primary collateral. Trade activities and service sector corresponds to two-third of all borrowers.

ProCredit Bank applies generally high interest rates reflecting the inherent risk perceived.

ProCredit Bank is part of a network of specialised microfinance institutions. In Romania, Banca de Microfinatare is part of the network.

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41 In 2002, 50% of German start-ups were financed by the Sparkassen-Finanzgruppe (Savings banks). Between the "Hausbanken" (local retailing bank) involved in DtA programmes targeting start-ups, 60% are Sparkassen (+8.3 % in the last five years).

42 Credit Unions are members of European Association of Co-operative banks, www.gebc.org. Savings Banks are members of the European Group of Savings Banks, www.savings-banks.com.

43 Caixa Catalunya and Fundacio Un Sol Mon: see www.unsolmon.org

44 According to ECB (2000): EU average is 135% of GDP, where the range in the Candidate Countries is between 20 and 70% (except Malta and Cyprus); IMF and SP December 2002; 105% for MS and 39% for Candidate Countries.

45 The state of microfinance in CEC and NIS, Sarah Forster, Seth Greene and Justyna Pytkowska, Microfinance Center, with the support of CGAP Regional Reviews, 151 pp, 2003, Washington D.C., USA.

46 www.procreditbank.com

Poland : Fundusz Mikro Ltd., www.funduszmikro.home.pl

In Poland, a limited liability company, Fundusz Mikro Ltd., was created with the support of USAID in 1994: the donor provided some € 22 million as a start-up grant. It reached the break-even point after five years of activity and has been considered to be financially sustainable after seven years since its creation. It is a mass operation, with an average of 7,000 loans per year (6,000 loans in 2002, some € 20million of microloans awarded) and interest rates between 15 and 21% in 2002.[47] It appears to be a sound and sustainable business model able to provide microcredit with an average size of € 3,000, an average maturity of 8.5 months and a default rate of 4.48%, as of 1st November 2002.[48] The impact on gender aspects is positive: 60% of the borrowers are women. Part of the affordable handling costs incurred by Fundusz Mikro Ltd. comes from two facts: 50% of the operations are a second loan to the same borrower, thus reducing the cost of the credit application assessment; and in order to get a better interest rate, borrowers have to organise themselves in a group of 4 (or 5) micro-entrepreneurs in order to offer an informal mutual guarantee scheme to the finance provider, each person being responsible jointly and severally for all outstanding loans. The concept supposes full confidence among partners of this informal network.

2.5.3 Microcredit by NGOs[49]

The dynamics of the microcredit provision by NGOs is interesting to follow. NGOs are following a wide range of objectives, in particular, social inclusion.

The emergence of microcredit provided by NGOs for social purposes is particularly important in the UK (Community Development Finance Institutions- CDFI), and to a lesser extent in the rest of the EU. Several factors could explain partly this situation: an important deregulation of financial services; low cost for creating such a service; reluctance of banks to be active in this market segment; greater flexibility; new technologies development. These microcredit institutions,[50] however, only offer part of the services provided by banks; the quality of services provided is uneven; and specialised banking know-how is lacking. It seems therefore premature to draw general conclusions on this experience.

For fifteen years, two main NGOs have emerged and developed in the EU to promote the creation of micro-enterprises among socially excluded people, such as unemployed persons: ADIE in France and Prince's Trust in the UK. They reach to the lower-end of self-employed entrepreneurs and business creators, with a maximum of € 5,000 per loan for ADIE and € 7,500 for Prince's Trust. To provide their services, these organisations receive between 60% and 90% of their annual revenues from public subsidy sources (national, regional or even European funding). Their operational sustainability is around 20%, far from the benchmark of microcredit banking or banking-like practices (from 80% up).

Their economic justification comes from the fact that, through this channel, the public subsidy support on average is between € 2,000 and € 5,000 per micro-enterprise created, whereas unemployment allowances cost some € 18,000 p.a. for one unemployed person. Microcredit by NGOs is an efficient tool to fight social exclusion and to reach unbankable micro-enterprises and make them creditworthy, a crucial first step before becoming bankable. It is more a model for an active social policy, more than a tool for enterprise policy.

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47 See www.funduszmikro.home.pl for full disclosure of history and results, as well as a statement of financial position, including profit for last financial year.

48 Delinquency rate (<180 days late) as % of outstanding balance.

49 "social credit" is not an appropriate wording for the microcredit provision by NGOs; these operators provide loans and get repayments from borrowers, use indicators such as default rate and loss rate to monitor their activity. Their target public is however excluded persons considered as unbankable.

50 Now represented by an association (Community Development Finance Association- CDFA): www.cdfa.org.uk

France: ADIE, www.adie.org

Since a new French legislation was adopted in 2002, ADIE (a non-profit association under French law of 1901 on associations), with its 22 regional offices and 98 local offices, has been accredited to borrow from banks in order to lend to micro-entrepreneurs. The latter are unemployed persons or persons receiving social allowances ("Revenu Minimum d'Insertion" or RMI). In 2002, it provided loans to 5,000 new micro-enterprises (as milestones: 3,500 in 2001; 1,600 in 1998; 850 in 1996) with an average of € 3,500 per loan (€ 17million in 2002), contributed to create 16,000 micro-enterprises and 19,000 jobs in the last 9 years. The current default rate is 6.5 %. As of 1st January 2003, the interest rate applied is 6.02% p.a., plus a contribution of 0.1% per month, and the maximum maturity is 2 years. The borrower needs to provide 50% of the loan amount as guarantee ("caution solidaire") from friends and family. Up to now, all these microloans were assessed and decided by ADIE (a representative of the partner bank being invited to participate in the meetings of the Credit Committee), but 70 % of them were disbursed by the banks, in accordance with the Banking law. The risk is shared between ADIE (70%) and the bank (30%). In case of non-repayment of three instalments, ADIE buys the loan from the bank and recovers it directly. ADIE is also involved in business support services, by offering training, mentoring and advice to creators with insufficient skills. The survival rate of created micro-enterprises is 75% at two years, which is the same ratio for French start-ups in general.

To offset partially its administrative costs, ADIE is receiving public subsidies from different sources: in particular, the European Social Fund and ERDF have been awarding some € 1.8 million per year. The high administrative costs are due to the non-financial support service intensity required by ADIE's clients, not to the financial service performance.

Prince's Trust is interesting in particular due to the size of its activities. Prince's Trust of England and Prince's Scottish Youth Business Trust are separate organisations but share similar objectives: the latter is however providing growth credit, in addition to start-up credit.

United Kingdom: The Prince's Trust, www.princes-trust.org.uk

The Prince's Trust, a registered charity involved in social credit since mid-1980, contributed to the creation of around 50,000 micro-enterprises by young disadvantaged people, some of them being ex offenders. The interest rate does not reflect the underlying risk as it is limited to 3% p.a. and the loan repayable over a period of 3 years (5 years as of 2003). No collateral is required. As with ADIE, the microloan activity is part of a package, which includes training, mentoring and other business support activities. In the last years, it supported the creation of 4,000 micro-enterprises p.a. with an average of € 4,000 per loan (€ 16 million. p.a.). The cost of the creation of one new business is estimated at € 5,000, of which € 800 correspond to its own handling costs. Another similarity with ADIE (22 regional offices), is that it has a national coverage with some 60 area offices. The survival rate of created micro-enterprises at 3 years is 60% and the loans recovery rate is estimated at 60%. Its business model seems therefore not to be self-sustainable. With a default rate around 40%, there is a big difference with both mainstream banking practices and the policies of many other micro-lenders.

Prince's Trust cannot be considered to be a typical case in the United Kingdom. In particular, regarding the interest rate policy, other microcredit institutions are more market-driven. For example, Industrial Common Ownership Finance (ICOF) has been in existence for about the same length of time and is fully sustainable.

Both the Prince's Trust and ADIE received support from EIF: the former in 2000, within the Growth and Employment initiative; the latter in 2002 and The Prince's Trust also received support in 2003 within the MAP financial instruments, via the microcredit guarantee window.

Spain: ICO microcredit programme

At the end of 2002, ICO of Spain, the national promotional bank, decided to launch a social microcredit programme of € 18million p.a. ICO is providing credit to local banks, which are in charge of retailing the loans to micro-entrepreneurs directed to them by social agencies and business support services.

Actually, the amount is limited if we compare it with the € 120 million p.a. of microcredit (<€ 25,000) awarded by ICO to micro-enterprises under its SME programme.

3 BUSINESS SUPPORT SERVICES

A business support service is a non-financial service, such as training, technical assistance, mentoring, advice provided to an enterprise. This service is an important factor to increase the sustainability and the life cycle of an enterprise. Usually, this service is partially supported by public funding.

3.1 Impact on survival chance

Apart from the financial service (lending), non-financial business support services (BS) are provided in almost all Member States[51], but are not used with the same intensity. Business support is provided in some Candidate Countries.

Slovenia: the Programme of Voucher Counselling (PVC)

Business support services are implemented under the PVC: the services are provided by licensed counsellors and the State can provide at least 50% of the service priced to SMEs.

Their positive impact on the survival chance of a start-up depends, in particular, on several factors[52]: co-ordination with access to finance, support to the business plan drafting, mentoring, training, appropriate pricing policy. Where some factors are lacking, the survival chance of the start-up is limited.

Coherent support services need to be assured, so that micro-enterprises can easily access to a package of services covering all the main management functions.

Public authorities should have a strategic approach for the support that they provide or sponsor and ensure that it is well co-ordinated with other services provided, such as financial, particularly at a regional level. New stand-alone initiatives should be avoided.

It is also important to ensure that support service organisations have access to the necessary human and material resources to provide top class services. In particular, information technology resources need to be frequently reviewed.

Regular evaluation of the effectiveness and efficiency of business support services should become an integral part of the culture of support services provision. Evaluation findings can be used by support service providers and policy-makers for continuously improving the quality, design and cost effectiveness of support services.

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51 SEC(2001)1937-28/11/2001 Commission staff working document: "creating top-class business support services"

52 Annual surveys by the Swedish institution ALMI; see www.almi.se and: www.nutek.se

Sweden : ALMIs annual survey, www.almi.se

ALMI offers both financial and non-financial services. Face-to-face, ALMI meets with approximately 100,000 SMEs and potential SMEs each year. Of these, some 24,000 become involved in extensive development programs. It also assists in the evaluation of approximately 3,500 new technology concepts and products annually, and contributes financially to some 2,400 innovations. At the end of 2001, ALMI had extended credit to nearly 4,500 client companies. In total, ALMI handled 2,023 loans in 2001, of which 324 were microloans for women entrepreneurs.

In order to assess the benefits, ALMI continuously performs growth and development studies on its clients with random, non-client control groups. ALMI even measures the client satisfaction every year. The studies are used mainly in two principle ways. The first is to make direct improvements in the work at ALMI's regional offices, and second, benchmarking between the regional offices and with closely related organisations:

- Survival rate by ALMI's clients:

  Young companies have a survival rate of 74% after five years.

  Young companies with more than € 12,000 in annual turnover have after five years a survival rate of 84%.

  The corresponding figures for the Comparison Group, composed by Companies "Similar to ALMI's clients" are 68% and 41%.

- Growth performances by ALMI's clients, increase in sustainable jobs:

  After five years, young companies have increased sustainable jobs by 85%.

  The corresponding figure for the Comparison Group is 24%.

- Growth performances by ALMI's clients, increase in turnover:

  Young companies have increased their turnover by 145% after five years.

  The corresponding figure for the Comparison Group is 49%.

- Growth performances by ALMI's loan clients, without or with business support service, increase in turnover:

  Young companies with business support, have after three years, increased their turnover by 40% more than the Comparison Group.

- Client satisfaction of ALMI's loan clients:

  89% of the clients think that ALMI is a good supplement to banks.

In 2001, ALMI's operational sustainability ratio was 100.1%.

In addition to evaluation aspects, coherent pricing policies should be developed for the various categories of support service and clear policies developed on the relationship between public and private provision.

As a general comment, where the intensity of these business support services is higher, the survival rate of start-ups in their fifth year is also higher. Overall, the business support service is operated by a specialised institution, such as a Chamber of Commerce and Industry, and the financial service by a financial institution. Sometimes, the financial institution accepts to provide a fee to the business support service provider.

Belgium: Fonds de Participation, www.fonds.org

In Belgium, a network of business support services provides mentoring to the start-up founder during 18 months after the award of a microcredit. A fee is paid (€ 120 for each selected credit application and € 2,000 as a lump sum for mentoring service) by the public promotional bank to the support service organisation because mentoring is expected to reduce the failure risk of start-ups.

3.2 Integration of lending and business support service within a single body ("one stop shop")

In the case of NGOs, both financial and non-financial services are provided by a single body ("one stop shop"). Unlike the general practice of NGOs, a major trend towards the integration of financial and non-financial services under a single body has not been observed in the banking sector. Where mainstream banking is not active in micro lending, some business support service providers have added financial service to their activities. By merging both activities, economic gain is, in theory, possible due to economies of scale.

On the legal side, however, a conflict of interest could appear, for example, where the business support service prepares or supports the preparation of the business plan and is also in charge of the selection and the award of the loan. The fact that one single body is providing technical assistance (or advice) and also a credit could create legal uncertainty: if a borrowing company failed after getting a loan from and paying for an advice to the same body, this combined service could be challenged by the company before a court for bad advice and therefore liability in the bankruptcy of the company. This could give some grounds for a very complex legal situation.

Where financial and non-financial services are part of a single body, a clear separation of functions and accounts between financial and non-financial services should be foreseen. Among the state-owned promotional banks, some already have both financial and non-financial activities with a clear separation of functions and accounts between them (KfW…). Synergies between financial and non-financial services is therefore a major issue in providing a full support to start-up and thus increasing its survival chances.

Hungary: Hungarian Foundation for Enterprise Promotion (Magyar Vállalkozásfejlesztési Alapítvány, MVA)

The Micro Credit Programme (MCP) started in 1992 and is operated by a network of local enterprise agencies (LEA) consisting of 20 units and approximately 120 sub-offices throughout the country. It has been co-financed by the EU/PHARE and Hungarian central budget resources.

A Memorandum of Understanding signed on 17 May 2000 by the Ministry of Economy and MVA, approved by the European Commission and the Minister without Portfolio responsible for the co-ordination of the Phare programme, established the National Micro Credit Fund (NMCF). It centralised the funds disbursed earlier and declared the NMCF property of the Hungarian State. The new centralised system has been in place since 1 July 2000. A total loan amount of € 72 million had been awarded in the following 18 months.

The MCP follows the rules established in the Micro Credit Manual. The LEAs microcredit committees take the credit decisions. MVA and the participant bank (Postabank Ltd.) are represented by one member each in these committees.

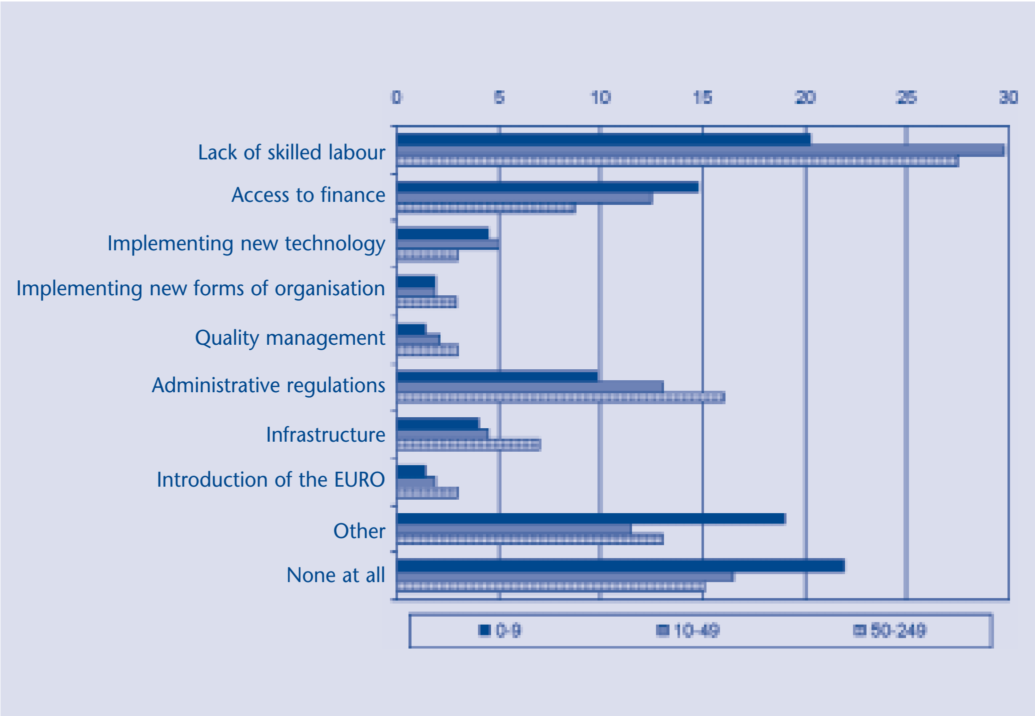
MCP terms and conditions in 2003 are as follows: maximum amount: € 24,000; the interest rate is the Central Bank's base rate at the contract date; maturity: min. 3 months, max. 5 years; grace period: max. 6 months; borrower's own contribution: min. 20 % of the loan amount; re-payments and interest are due monthly. Microcredit may be applied for repeatedly but the actual outstanding amount must not exceed the size of the maximum individual loan. Entrepreneurs get business support services, free of charge, via the enterprise agencies along with the financial assistance. In order to ensure the sustainability of the Programme, increase its financial resources, and improve the quality of the portfolio, participating banks and supporting guarantee schemes will be closely involved soon in the Programme.

4 MICROCREDIT PRODUCT DESIGNING

4.1 Access to finance

Access to finance remains the main concern of a microcredit applicant with the cost of that finance the second concern. For micro entrepreneurs, the affordability of the weekly or monthly repayment is more directly important to them than the interest rate charged. As a matter of fact, market growth expectations are the main driving force ("to be at the right time, at the right place. This is particularly true in a period of low inflation and low base rate. When micro-entrepreneurs are asked about the major business constraint for their business development, access to finance is perceived to be the most important one. The perception of bigger companies, in particular medium-sized ones, is quite different.

Major business constraint 2001, by size of existing enterprise (percentage of SMEs)[53]



The interest rate becomes crucial, however, when, due to an economic downturn or unforeseen circumstances, the enterprise needs an overdraft. In this case, the interest rate level may become a burden, because the enterprise is facing a slowdown of its sales and the credit institution support is requested at the worst time.

Under such circumstances, the interest rate and access to finance are two faces of the same problem. This is why, in addition to credit, other services are important in order to anticipate, as much as possible, unforeseen circumstances to allow the best possible risk assessment and management by lenders.

[53] Observatory of European SMEs, 2002 n°1, p.13.

In general, when a microcredit is the only source of external finance, it is a "single chance" and so the initial support provided to a small enterprise is very important. By demonstrating their ability to successfully service external finance, however, the small entrepreneur begins to build a financial track record and thus should improve the likelihood of being able to access further finance in the future, evidence of his/her ability of being successful, a "second chance" to get external finance will be therefore less difficult.

As noted already in this report, the small entrepreneur is almost always seeking loan (debt) finance, although there are a minority of cases, particularly those in which there is a real prospect of significant early growth, in which some form of scale equity or quasi-equity investment may be appropriate. A recent study[54] in the UK resulted in the development of a model through which equity packages within the € 25,000 scope of this report could be delivered.

4.2 Below market interest rate product

In several European countries, a below market interest rate practice (soft loan or even interest free loan) still exists. According to different sources, however, these soft loan funds provided by private microcredit institutions should be regarded as being of limited value[55] and further development of these funds should not be encouraged. Such private funds cannot be self-sustainable, and therefore independent of public subsidies.

FINNVERA

Current European microcredit practices are spread from grants to "all costs covered" products. There are some examples of "smart subsidy". Finnvera provides a below market interest rate, with State financial support. The effective rate for a first microloan for a client is:

6 month Euribor (at the time 2.263%) + premium of 1.5% + handling fee of 1.5%.

Calculated for an average loan size (€ 18,231), Finnvera receives a special interest subsidy of 3% paid by the State on the basis of the microloan portfolio.

The above mentioned subsidy is not included in the calculation of the effective interest rate paid by the client. As a result of the interest subsidy, Finnvera charges a premium of 1.5% instead of 4.5% for a microloan. One client (enterprise) can have a maximum amount of €35,000, either in one shot or in several steps.

Beyond this amount, the client will be financed with other financial instruments and pricing based on risk rating. As a financial institution, Finnvera borrows its capital from the financial and capital markets through bonds, promissory notes and other vehicles.

54 Launch Pad - A model for a first stage equity and loan fund by Kevin Caley and Ian Cruddas, Launchpad Fund, January 2003, Ashby-de-la-Zouch, UK. www.launchpadfund.co.uk

55 The State of Community Development Finance 2001, by Sam Collins, Thomas Fisher, Ed Mayo, Andy Mullineux and Danyal Sattar, NEF, July 2001, 48 p., Birmingham, UK. See p 27.

Using the EU reference rate (or equivalent, such as Central Bank base rate) as the benchmark, the situation can be presented as the following:

Average interest rate in relation to reference rate (%) by country

Average interest rate over reference base rate (%) if loan has a maturity of...	0-1 year	1-3 yrs	3-5 yrs	over 5 yrs	Reference rate[56] used for average calculation
Austria[57]	n.a	n.a.	n.a.	-0.3%-1.175%	4.8%
Belgium[58]	n.a.	- 3%	n.a.	- 4%	4.8%
Czech Republic	n.a.	n.a.	-5%	n.a.	8% (reference rate)
Cyprus	2.75%-3.25%	2.75%-3.25%	2.75%-3.25%	2.75-3.25%	4.5% (base rate)
Germany	4%	4%	4%	4%	4.8%
Denmark	n.a.	n.a.	n.a.	n.a.	n.a.
Estonia	1.1%	0.87%	0.5%	1%	4.8% (base rate)
Finland	n.a.	-0.28%	-0.49%	0.48%	4.8%
France	n.a.	n.a.	1.70%	n.a.	4.8%
Hungary	0%	0%	0%	0%	central bank base rate
Ireland (interest free loans)	n.a.	-5%	n.a	n.a.	4.8%
Italy	1.91%	1.91%	0.91%	0.91%	4.8%
Latvia	-1.66%	-0.72%	-0.72%	-0.72%	8.85%[59]
Lithuania	1.826%	1.943%	1.943%	n.a.	6.02% (reference rate)
Malta	n.a.	n.a.	n.a.	2%-4%	n.a.
Poland[60]	11%	0%	-6%	n.a.	n.a.
Romania	3%	3%	n.a.	n.a.	n.a.
Slovenia	2.5%	4.5%	5.5%	6.5%	n.a.
Sweden	n.a.	n.a.	1.7%	2.36%	5.68%
United Kingdom[61]	4%-16%	4%-14%	4%-10%	4%-6%	4% (hurdle rate or reference rate)

Apart from the interest rate, a way of establishing the general features of microcredit programmes consists in reviewing their collateral policy. In the majority of Candidate Countries, real estate is not used as collateral, because in case of bankruptcy, the legal process may last up to five years.

56 For Eurozone countries, the reference is the EU reference rate. For other countries, the national banchmark is indicated when available.

57 Young Entrepreneurs Support Programme, Austria Wirtschaftsservice. Above reference rate (secondary market rate for bonds issued by the Republic of Austria): -0.3% for floating loan rate; -1.175% in case of fixed interest rate.

58 Upon request of EC services, Fonds de Participation is taking into account an additional 4% in case of lack of collateral from the borrower.

59 Internal Mortgage and Land Bank of Latvia (MLBL) reference rate (8.85%) of SME commercial loans in EURO currency used (weighted average OECD currency rate 2002 – 5,8%). MLBL is the main microcredit provider in Latvia.

60 Poland: + 11% is Fundusz Mikro; -6% credit for rural areas.

61 In the United Kingdom, those CDFIs receiving public support, the interest rate must be at least equal to the Hurdle Rate (e.g. Reference Rate + 4%) in order for the transaction to be deemed to be fully commercial and thus free of any state aid. The higher upper limits to the ranges for shorter loans reflect the fact that most mico-loans, generally < €1,500, are typically for between 6 and 18 months.

Share of typical collateral for specific microcredit programmes (%) by country

Share of collaterals for the microcredit provider (%) by country	Real estate	Other fixed assets	Guarantee	Receivables	No collateral
Austria[62]	0%	0%	100%	0%	0%
Belgium	0%	0%	0%	0%	100%
Germany[63]	0%	0%	80%	0%	20%
Estonia	5%	54%	41%	0%	0%
Finland	0%	0%	10%	10%	80%
France	0%	0%	76%	0%	24%
Hungary	90%	10%	0%	0%	0%
Ireland	0%	0%	0%	0%	100%
Latvia	60%	26%	14%	0%	0%
Lithuania	55	20	10	15	0%
Poland	30%	19%	50%[64]	1%	0%
Romania	up to 100%[65]	up to 100%[66]	Accepted if available	0%	depending on the programmes
Slovenia	50%	0%	50%	0%	0
Sweden	0%	0%	0%	60%	40%
United Kingdom	0%	0%	0%	0%	100%

4.3 Above market interest rate product

Self-sustainability is a major issue for a microcredit fund. One way of achieving this goal can be to charge an above market interest rate. An above market rate is acceptable where the risk is higher. For example, in a pure subordinated loan, with no collateral at all by the micro-entrepreneur, the interest rate can be higher than for a traditional loan in order to cover all risks.[67]

Another reason for increasing the interest rate is the risk associated with the maturity: statistically, 50 % of all new companies will disappear over a five-year period.

One more explanation is: the interest rate applied to a microcredit can be high because the "alternative is either borrowing at even higher rates, perhaps from an informal money-lender, or not borrowing at all"[68]. In case of credit supply-side monopoly, however, high interest rates might reflect the inefficiency of the credit institution: under such circumstances, competition might solve this problem[69].

Several Member States define an interest rate cap to protect borrowers (usury rate): this legal constraint denies the possibility for the credit institution to increase the interest rate in order to cover all its risks and therefore leads to a lack of supply of microcredit to micro-enterprises, in particular for innovative start-ups, whose risk is generally perceived as high.

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62 AWS programmes: for loans up to € 75,000, a personal guarantee is sufficient; other collateral can however be required.
63 KfW products: StartGeld and Mikro-Darlehen.
64 Poland guarantee by regional/local funds or individuals in the case of Fundusz Mikro.
65 Covering loan size, plus interest rate.
66 Idem.
67 In the recent UK *Small and Medium Enterprise Venture Capital and Loan Fund*, in the case of unsecured loans, EC services requested a premium of 4% or higher and is included beyond the prevailing UK reference rate (State Aid N 620/2002).
68 IMF WP/02/159, ib, p.8.
69 CGAP Microfinance Consensus Guidelines, Sep.2002, p. 26.

The relatively high administrative costs of a microcredit however need to be dealt with: one option for a self-sustainable microcredit activity is to be able to manage mass operations to offset the likely tiny profitability margin. Another option could be considered: for allowing the microcredit operator to be fully self-sustainable, the public authority could increase the ceiling of usury rate, in countries where such a rate is legally binding. The difference for a microcredit borrower could be affordable: often, the microcredit has a very short maturity and therefore the additional cost per month for the borrower would be minor, if not negligible.

4.4 Step by step approach

One of the best effects of a first successful[70] microloan is to establish a relationship of trust between a lender and a borrower for the next financing round. In this regard, several parameters should be taken into account:

- A first successful microcredit is a way of getting credit history references;
- Where a micro-enterprise gave evidence of its capacity to pay back its first loan, depending on its needs, the second loan may be awarded more easily, with or without an incentive on the interest rate, for a longer maturity, or with a bigger amount.

In this regard, Aspire microloans for business limited offers an interesting example of step-by-step approach.

United Kingdom: Aspire microloans for business limited[71]

Aspire is one of the first dedicated micro-finance organisations in the United Kingdom and Ireland providing access to finance for the self-employed and micro-businesses at commercial interest rates.

Aspire is a partnership between the main banks in Northern Ireland (Bank of Ireland, First Trust Bank, Northern Bank and Ulster Bank) and other institutions.

In July 2001, the independent auditor's Interim Evaluation Report said: "Traditionally, support for these micro-businesses has tended to take the form of grant-based financial assistance or soft loans. In contrast, Aspire [works] closely with clients to develop a sense of good commercial practice by providing loans with realistic but commercial repayment schedules."

Key figures since lending operations got started in February 2000:
- Aspire lends between € 300 and € 7,500 for first loans. Repeat loans can rise to € 22,500.
- Loan terms are between 3 and 9 months for first loans and up to 18 months for second and repeat loans.
- The average time for processing a loan is 12 days.
- First loans are charged at 14% over base rate (19.5% APR) with a reduction to 12% over base for second loans (17.5% APR) and 11% (16.5% APR) for repeat loans.

Aspire's interest rates are set: to reflect the high cost of servicing its market niche; to focus the loan officers on reaching out to micro-entrepreneurs who are financially excluded; to allow the organisation to progress towards operational sustainability; to ensure that those businesses which are "bankable" go to the banks for their finance.

By January 2002, Aspire has lent (€ 808,895) to micro businesses and the self-employed in Belfast. Its write-off rate is 6%. Almost 80% of loans went to businesses located in government-defined areas of particular deprivation in Belfast.

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70 Where all repayments were paid in due time by the borrowing company.
71 www.aspire-loans.com

It should be noted however that the financing needs (and the risk) do vary according to the business sectors and business ideas. These needs should be taken into account when deciding the maturity and the step-by-step approach. Tailoring the microloan maturity in the frame of a long maturity could be an option.

5 RECENT DEVELOPMENTS IN MICROCREDIT SUPPLY

5.1 Basic lessons learned

When designing a microcredit product and involving partly public funds, several elements should be taken into account:

- Basic principles for public-private partnership:
  - evidence of a market gap or a market failure;
  - non market distortion impact;
  - respect of European Union State aid rules;
  - co-ordination and coherence between financial and non-financial services.
- On the microcredit provider side:
  - avoid cross-subsidy between products of the microcredit institution;
  - on line access at national level of previous credit history references of any borrower;
  - the interest rate should (gradually) cover all costs and the microcredit product be commercially driven (at least seeking the institution self-sustainability)[72];
  - to prepare a self-sustainable product, interest rate and term are two main flexible components to be dealt with.
- On the micro-enterprise side:
  - access to finance is the main concern;
  - the repayment will allow the micro-enterprise to get credit history references.

5.2 Milestones toward sustainability

The emergence in recent years of several large-scale operations of microcredit extension and guarantee schemes is the main change in the Member States and the Candidate Countries. To foster this positive scenario, the EIF offers the MAP microcredit guarantee window to financial institutions.

Experience has shown that the microcredit institutions applying a market-driven approach improve their profitability as they mature. This could reflect a learning curve ("learning by doing") and the necessity of getting gradually appropriate risk management tools, appropriate operational arrangement and better knowledge of the market. It is also, for the microcredit institution, a question of getting a sufficient number and size of operations in order to decrease fixed expenses. The number of new microloans p.a. by loan officer is a benchmark in this regard.

Available data suggests however that the operational sustainability is not obtained immediately and depends on an appropriate application rejection rate by the microcredit institution: it therefore suggests the need for a substantial injection of capital and/or subsidies, during early stage of operations.

Based on European experiences, the operational sustainability[73] benchmark of micro-lending extension seems to evolve the following way:

- 80% after two years (Finnvera: Finland);
- 90% between 3 and 5 years (Finnvera: Finland);
- 100% between 5 and 8 years (ALMI: Sweden; Fundusz Mikro: Poland).

Consequently, financial sustainability can be reached in between 7 and 10 years.

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72 See www.inaise.org/EN/txt_01240.html (about: Aspire microloans for business limited)

5.3 Fee policy

As already mentioned, the administrative costs associated with microcredit activities are high relative to a microloan amount. Among the administrative costs, wages are important as providing microcredit is labour-intensive[74]. The ratio of these costs will however progressively decline with the portfolio size. To mitigate this factor, different forms of partnership have been agreed recently between public promotional banks and retail banks as well as business support providers.

EIF fee policy

Beyond the risk sharing method used by EIF in the framework of the MAP microcredit, a fee is awarded to the microcredit institution for each microloan provided. This technical support to the intermediaries is made available in the form of a lump sum, in order to partially offset the relatively high administrative costs inherent to microcredit. Such support does not exceed € 200 per loan granted and is payable to the financial intermediary, subject to the intermediary's representation that it has not granted or guaranteed any other loan to the same final beneficiary. The maximum aggregate amount of technical support payable to one intermediary is € 100,000.

Germany: Mikro-Darlehen fee policy

In Germany, a fee is awarded by KfW to the local bank for each microloan selected by KfW: € 600 in the case of Mikro-Darlehen.

Belgium: Fonds de Participation fee policy

Two different performance fees are offered: one to the bank which pre-selected an application; or one to the business support service which directs the applicant to the Fonds de Participation.

In the case of a "Starter loan" by a bank, the fee paid by Fonds de Participation to the retailing bank is € 310. In the case of a "Starter loan" or a "Solidarity loan" by a business support service provider in charge of mentoring, the Fonds de Participation provides to the latter € 120, plus € 2,000 for the post-creation mentoring.

Even if the Phare SME Finance facility was a programme designed in the very specific framework of the adhesion process of candidate countries, it remains a significant co-operation programme aiming to improve the access to finance of SMEs. The provision of grants by the Phare programme (EU budget) for both technical assistance and performance fees has been co-ordinated with loan operations carried out under market conditions by EBRD, CEB-KFW and EIB.

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[73] Operational sustainability = income from clients/(refinancing costs + credit losses + administrative expenses); financial sustainability = income from clients/(refinancing costs + credit losses + administrative expenses + cost of own fund).

[74] International Monetary Fund, Microfinance institutions and public policies, Daniel C.Hardy, Paul Holden, Vassili Prokopenko,p.7, WP/02/159, Sep.2002, p. 36.

Phare SME Finance Facility

The year 2002 was characterised by an increased focus on developing the Candidate Countries banks' capacities to provide microloans to SMEs. Under the SME Facility, EC funded incentives, e.g. Performance Fees and Technical Assistance, are structured in a way that they encourage local financial intermediaries to focus increasingly on microloans, i.e. loans with an average size of € 30,000.

The EBRD confirms in its 2002 annual report that the average loan size has declined from € 25,000 at the end of June 2002 to € 22,000 at the end of 2002, as more local banks are targeting microloans.

The targeting of microloans is also greater where a technical assistance fee has been provided to develop credit scoring or streamline credit procedures.

5.4 Networking

Beyond this recent performance fee policy among microcredit providers to institutional customers, another trend is the emergence of networks as a way of exchanging best practices, partly or fully related to the microcredit business segment.

NEFI, www.nefi.be

Created in 1999, the Network of European Financial Institutions (NEFI) is composed of seven European financial institutions, not specifically active in microcredit: ALMI (Sweden), BDPME (France), Finnvera (Finland), ICO (Spain), KfW Group (Germany), MCC (Italy), SNCI (Luxembourg).

The scope of their activities goes beyond microcredit and encompasses the promotion of SMEs in general. In 2002, these institutions financed 115,000 SMEs with loans and guarantees amounting to more than € 23 billlion.

In April 2003, a network of EU specialised organisations active in microcredit has been launched.

European Microfinance Network (EMN), www.european-microfinance.org

A new network has been launched in April 2003 by 22 EU institutions (promotional banks, foundations, limited companies created by credit institutions, non-profit organisations, universities, and consulting companies) of 11 Member States to promote best practices in the EU: the EMN, with headquarters in Paris.

The network board is composed of members of ADIE (France), ANDC (Portugal), Aspire (United Kingdom), Un Sol Mon Foundation (Spain), Evers&Jung (Germany), Finnvera (Finland), New Economics Foundation (United Kingdom).

In the Candidate Countries, a network involving microfinance institutions with different legal forms has been operating for several years. It is based on the same model as that of the EMN.

Microfinance Center (MFC), www.mfc.org.pl

The MFC has its headquarters in Warsaw, Poland. Launched in 1997, it serves as a network of more than sixty microfinance institutions. The range of activities includes training, technical assistance, impact assessments, workshops, seminars, exchange visits, and dissemination activities. MFC publishes a Policy Monitor sponsored by the Open Society Institute, which news and views from Candidate Countries and New Independent States (NIS), country highlights, briefs from the world and policy analysis. It organises an annual Conference and a Micro-finance Policy Forum.

According to its initiators, synergies between EMN and MFC could be found in the future.

6 RISK ASSESSING, SCORING AND AWARDING DECISION

6.1 Risk assessment

The assessment of an enterprise's poetential for profitability by the finance provider is a key factor of any microcredit activity and its sustainability. In this regard, since the beginning of its microcredit programmes, FINNVERA has been applying and developing its assessment method, which has resulted in a reduction of the default rate from 6% to 2% for the microcredit for women entrepreneurs between 1998 and 2001. The methodology used mixes both qualitative and quantitative aspects.

FINNVERA: risk assessment

To minimise risks, a business analysis is carried out to evaluate the enterprise: organisation structure; objectives; markets; operations; future development; planning; enterprise's development potential and core competence; continuing competitiveness in the future; financial statements. From this analysis, the risk category is determined.

FINNVERA uses a eight-category system in assessing the business risks of loan and guarantee applications. Main classifications are spread from A1 (very profitable), A2, A3, B1, B2, B3, to C (risk of bankruptcy) and D (defaulted). Assessing an enterprise business risk category is a four stage process: a mechanical risk category is determined on the basis of the financial statements (profitability, liquidity and financial standing); review of risk category; on-the-spot business analysis (management. weighting: 30); business idea (30) and financial statement (40); summary to determine a revised risk category.

Each enterprise risk category and development trends are reviewed and updated at the time it submits a new application for finance, whenever justified reasons arise, or at least once a year.

Anticipating the implementation of the Basle II Capital Accord, some credit institutions will also introduce new procedures as early as 2003.

Germany: KfW risk assessment in 2003

Since 2003, KfW has been using a credit assessment procedure with a credit rating system. KfW chooses to anticipate Basle II by introducing a risk assessment based, in particular, on loss given default of the portfolio. KfW has many years of experience with the financing of start-ups and SME. The data from this experience flow into the credit rating system. KfW will introduce a rating system with 20 grades and for each grade, there will be a calculated default probability (ratings 18, 19, 20 for defaulted loans). A decision rating for the client will be made for each loan approval. The approvals and disapprovals will be carried out by a rating score (cut-off) controlled by the central credit risk unit. Any exception to the cut-off must be justified. The cut-off is fixed to ensure the anticipated defaults are covered by the risk premium.

6.2 Microcredit award decision making

In all cases, the ex ante risk assessment is made by at least one financial institution. In some cases, for co-financing or risk sharing operations, the assessment is made by two of them: the national promotional bank and the local bank; or the bank and the guarantee fund; or the guarantee fund first, and then the bank.

In case of a double assessment, there is obviously an additional handling cost. Some new forms of partnership can be detected in this regard.

France : PCE of BDPME

A new practice was introduced in 2000: PCE, BDPME, the French public promotional bank, is delegating the decision and the application assessment to the retailing bank.

Other national promotional banks are still in charge of the awarding decision, but there is a clear trend towards quick, less burdensome application and decision-making processes (Belgium, Germany…).

Even if the awarding decision is made by the national promotional bank, the fact that any application is already appraised, thus filtered, by a local financial institution (or by a business support service) reduces the handling cost of the promotional bank and improves the quality of applications submitted to it. The motivation of the local bank to transmit acceptable ones is also coming from the fact that it is looking for getting part of the credit or sharing part of the risk. Efficiently managed, these partnerships are leading to a win-win situation.

It has been indicated recently however that the risk-sharing approach could lead to a reduced risk perception[75]. This statement is particularly accurate when the retailer is managing funds on behalf of the national promotional bank. It appears important, for the sustainability of the national promotional bank (or guarantee fund) to avoid using wrong incentives and sending bad signals to the retailer as well as the final borrower. A significant risk share should therefore remain with the retailer and the final borrower.

Denmark: Vaekstkaution loan guarantee programme, www.vaekstfonden.dk

Denmark offers an interesting example of a national guarantee scheme. Launched in August 2000 and redesigned in order to reduce losses, the scheme now accounts 95% of micro-entrepreneurs amongst its clients:
- with an increase of fees from 1.5 to 3% p.a. for the two first years,
- with a decrease of coverage from 75 to 66% and even 50%, in certain cases, and
- by making its own ex ante credit assessment.

6.3 Lessons learned about risk and default management

For the microcredit institution or the guarantee scheme, the distribution of the portfolio in risk classes is crucial in order to minimise defaults. This is a common practice among European micro-finance providers.

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75 Forum for enterprise development-guarantees and enterprise development; OECD and KREDEX, Tallinn, Estonia, 25-26 September 2002; Mr John Wasielewski "Experiences with guarantees in development: a recommendation to wholesalers of not providing more than 50% of guarantee, thus leaving, at least, the other 50% as collateral, has been considered to be a good bet".

In addition, the microcredit provider needs to be proactive after the decision of granting a credit:

- In case of late payment, this should lead to an immediate action by the microcredit institution towards the borrower. This is a significant message given by any finance provider, in particular by microcredit schemes with social inclusion purposes, where the borrower could interpret the lack of signal as a conversion of the credit into a subsidy.
- Ex post monitoring and risk management are essential in order to follow and monitor the portfolio performance, but also to adapt the risk management information tools with revised data.
- Regarding prevention, the active participation of business support services (mentoring…) is important to increase the survival chance of a start-up. Also, the introduction of a rating system for risk selection according to the forthcoming Basle II Accord might have a positive effect. In this regard, two aspects should be studied carefully: the rule of non-payment at 90 days past due, with flexibility up to 180 days; and a method integrating qualitative aspects. Finally, the experience gained by the credit institution loan officers in charge of microcredit is also a major factor of risk prevention.
- Regarding defaults dealing, where a promotional bank and a local bank are involved, the retailer cancels the loan. Where payments continue to be fulfilled by the debtor after cancellation of the microloan, the risk-takers receive the payments according to their risk share (guarantee share). One important point is a quick processing to reduce the costs of the on-lending institutions.
- Regarding debt recovery, where a promotional bank and a local bank are involved, the retailer is in charge. The promotional bank gets information only when the recovery process is finished and no more payment can be expected, e.g. from utilisation of collateral or repayment agreement if the debtor has a new job as an employee.
- Regarding any late payment, the client must be fully aware that he/she has to pay an interest payable on arrears.

7 IMPACT ON SMES

7.1 Size of programmes, number p.a. of small enterprises financed by a microcredit

In the framework of this microcredit report, the 2001 sample of microcredit operations that the members of the working group reported reaches a total amount of about € 3.5 billion.

This amount does not however reflect the total flows of microcredit in Member States and Candidate Countries, due to the lack of statistics in several countries, especially for microloans granted by credit institutions under "personal loans".

To give an idea of the importance of microcredits, for a country such as Italy, € 4.3 billion were awarded in 2001 to 113,000 micro-enterprises, which is an average of € 37,800 per loan: 90,000 operations were microcredits below € 25,000, corresponding to some €1.5 billion[76].

During our exercise, the following absolute figures of microcredit operations, either credit or guarantee, by countries have been identified for 2001:

[76] Fedart report 2001, Italy.

- More than 10,000 micro-operations (loans and/or guarantees): France, Germany, Italy, Poland, Spain.
  In France (BDPME), Germany (KfW) and Spain (ICO), promotional banks are among the major players. Banques Populaires-SOCAMA (France), CONFIDI (Italy), CESGAR-CERSA (Spain) are also major players. In Poland, the main players are two limited liability companies: Fundusz Mikro and Inicjatywa Mikro.
- Between 5,000 and 9,999 micro-operations:
  ADIE, a French NGO has been part of this segment since 2002.
- Between 1,000 and 4,999 micro-operations: Belgium, Finland, Hungary, Sweden.
  In the case of Belgium (Fonds de Participation), Finland (FINNVERA) and Sweden (ALMI), promotional banks are the main actors. Prince's Trust is the only NGO in this segment.
- Below 1,000 micro-operations: Denmark, Czech Republic, Estonia, Latvia, Lithuania, Ireland, Slovenia.

7.2 Survival rate

The survival rate of micro-enterprise is not yet used as a general indicator to measure the impact of microcredit. Moreover, according to general statistics about the survival rate, the situation is quite different between the countries, due to the intensity and the quality of business support services:

Five years after creation:

Germany: 80%[77]
Austria, Belgium: 75%; Finland 75% women microloan and 78% for small loans
Poland: 50% (70% with microcredit)
United Kingdom, Denmark: 40%.

Poland offers a clear illustration of the positive impact of the access to microcredit on the survival rate of start-ups: this correlation seems to be a general feature in both Member States and Candidate Countries.

As for France, important statistics do exist about the survival of new enterprises[78]. It appears that several positive factors are correlated with an above average start-up survival rate:

- the professional status of the entrepreneur: with previous entrepreneur's experience (33% of entrepreneurs); experience of senior position, executive or manager (18% of entrepreneurs);
- technical skills in the field of the business to create (57% of start-ups);
- the motivation: the willingness to establish an enterprise by vocation, as opposed to the necessity of establishing an enterprise as a way of finding a job, which appears to be a negative factor;
- access to a bank loan (22% of creations, plus 1% accessing venture capital), which is subject to an appraisal of the business project made by banks.

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77 General survival rate for start-ups 5 years after creation. For KfW, 80% is also the expected result for Startgeld, created in 1999: so far, the only statistics available is the survival rate at 3 years: 93%.

78 See Observatoire Agence Pour la Création d'Entreprises (APCE)-Chiffres 2001, p.24 to 30 (www.apce.com).

7.3 Creation of additional jobs

Research made about employment growth suggests that the majority of job creation is generated by a very small number of fast-growing enterprises.[79] Beyond the self-employment of the small enterprise founder, microcredit appears to be conducive to the creation of less than one additional job. Where data are available, the jobs created, including that of the founder, by country are the following:

Number of jobs created by microcredit

Belgium	Germany	France[80]	Hungary	Latvia	Lithuania	Poland	Sweden	United Kingdom[81]	EIF[82]
1.17	1.7	1.7	1.2	1.04	1.5	1	1.7	2	1.2

As a general trend, microcredit in Europe is targeting mostly self-employed or enterprises employing 1 to 2 persons, including the job of the founder. The main economic sectors targeted are consumer services, business-to-business services, trade retail and craft sector.[83]

Slovenia: National microcredit scheme and job creation

A national micro-credit pilot scheme was jointly introduced in 1996 by Small Business Development Centre and National Unemployment Office with the main objective to secure a number of new jobs. The scheme was introduced in five regions where national funds were complemented by local sources of finance. The real interest rate of 2 % p.a., combined with the aids of regional guarantee schemes and a six month repayment lag period was interesting enough to encourage strong demand for the credit line. The final result at the end of the project was 548 new jobs. The funds were depleted in the year 2000, but the scheme was continued in some regions due to additional resources that were attracted to the scheme. The level of satisfaction with the project is high by all interested parties, so certain efforts have been made to secure additional sources of funds from the national budget.

8 PERFORMANCE ASSESSMENT

8.1 Public-private partnership

In several cases, in the Member States and the Candidate Countries, the national government is playing an active role by promoting microcredit friendly measures through legislation and tax policy; by reducing red tape; by using a state-owned promotional bank as the credit provider of the system; or by providing a "shadow" guarantee such as the support often given at last resort to guarantee schemes; and also by encouraging business support service providers.

In doing so, the national or regional government is promoting entrepreneurship, the creation of start-ups and fighting the effects of any economic downturn.

79 Storey D. (1994) Understanding the small business sector, Thompson, London.
80 Idem. 1.7 is the general French ratio. For ADIE, it is 1.2.
81 Jobs created or retained. Based on experience to date of 500 loans made by CDFIs partially financed by the UK Government's Phoenix Fund to mid-2003.
82 Growth and Employment report 2001: it refers to almost all Member States.
83 Survey by FINNVERA, as of Jan 2003.

Any public scheme should of course take into account as a basic principle the market distortion effect and the rules on state aid. Where fairly designed, a tax exemption to investors or a counter-guarantee, at last resort, appear to be efficient and effective tools.

8.2 Greater leverage effect

A guarantee scheme is not always supported by public subsidies: for example, the French SOCAMA guarantee societies do not receive public financial support; the Italian CONFIDI are private companies, but managing both members' financial contributions and public funds.

According to AECM and different conferences held in 2002, it was indicated that, for a guarantee scheme, each € of public counter-guarantee can leverage € 10 of loans in the Member States and, in the Candidate Countries, the benchmark seemed to be around 1 to 6.

These ratios require comment: it is useful to distinguish between the leverage of the guarantee scheme as such, and a counter-guarantee scheme sometimes complementing the guarantee scheme. Based on some recent examples (2001), the leverage effect is the following:

Leverage effect of guarantee schemes and counter-guarantees

Country/ Scheme	Loan	Guarantee	Leverage by guarantor 31.12.2001	Equity mobilised by guarantee society	Equity mobilised by counter-guarantor	Final leverage by counter-guarantor
France/ Socama	€100	€80	21 x	80 / 21 = €3.81	No counter-guarantor	n.a.
Germany/ BüBa	€100	€80	20 x	80 / 20 = €4	Bund + Land 68 % → €2.66	100 / 2.66 = 37 x
Hungary/ Hitelgarancia	€100	€70	22.5x	70/22.5 = €3.1	State: 70% → €2.17	100/2,17 = 46.1
Italy/ Fedart	€100	€60	6.83 x	60/6.83 = €8,78	FEI /50% → €4.39	100 / 4.39 = 22.78 x

For these examples, representing large-scale schemes, each € of guarantor's capital allows between € 7 and € 22 of loan and each € of counter-guarantor's capital enables the provision of between € 22 and € 46 of loan.[85]

8.3 Performance indicators

To assess the performance of a microcredit scheme, there is a consensus that the enterprise survival rate and the number of jobs created are basic in measuring the economic impact, even if they are not used systematically to date.

Other indicators such as the default rate, loss rate, operational sustainability and financial sustainability are important to monitor the progress made by microcredit schemes towards their independence.

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84 source: AECM for 2001.

85 source: idem

Three main categories of indicators can be used:

- ***Institutional performance*** indicators are mainly output-oriented:

  These allow a clear picture of the microcredit coverage, default rate, annual losses, loan maturity of the portfolio, the intensity of public subsidy, operational and financial sustainability, as well as the average cost of a new job based on the infusion of microcredit and the part of public subsidy in it.

- ***Market development*** indicators are especially interesting where the private sector is not sufficiently developed:

  Number of microcredit operators and their geographical coverage; number of business support service providers and the willingness of micro-enterprises to pay for their services; awareness of existing financial and non-financial services among small enterprises;

- ***Economic impact*** indicators are useful to monitor the economic policy:

  The total number of enterprises created compared with those created with a microcredit support; the survival rate of enterprises at 5 years compared with the same rate for enterprises created with microcredit support; the average number of jobs created by micro-enterprises with microcredit support.

9 CONCLUSIONS AND RECOMMENDATIONS

9.1 Conclusions

1. *Promoting entrepreneurship*

The European Council of March 2003 made entrepreneurship a priority, with special attention to be paid to microcredit. Europe does not have enough entrepreneurs and small business founders often have no adequate access to external finance. This insufficient supply of microloans is a major issue, in particular where business founders are unemployed persons, women or part of ethnic minorities. Supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also of social inclusion.

Overall, a large number of financial institutions are not sufficiently active in this segment, but the situation varies: in some Member States, 3 out of 4 business founders receive a bank loan or at least an overdraft, but in other Member States, the ratio is 1 out of 4. In the majority Candidate Countries, the shortage of credit supply remains a major constraint for business creators and the growth of small enterprises.

2. *Market failure*

As banks often perceive microcredit as a high risk and low return activity due to the important failure rate and the high handling cost for loans below € 25,000, there is a market failure based on information asymmetry. This market failure is confirmed by several surveys showing that access to finance is perceived by small entrepreneurs as a major constraint for the creation of small businesses but also for businesses willing to develop.

3. *Public support*

Public support is available, and is already the norm in all Member States and the majority of Candidate Countries: measures are in place to bridge the gap in this area, at least partially. Against the evidence of a still existing market gap, however, additional measures have to be taken. Public support can be offered through an enabling environment and tax incentives for investors supplying funds to microcredit retailers.

Public support can also be offered by providing funds to specialised lenders, by sharing part of the risk with specialised guarantee societies and/or by promoting business support services.

4. *Public promotional banks*

In the context of the need for public support to microcredit, public promotional banks are playing an active role in several countries and remain an efficient and effective vehicle to provide part of credit and/or guarantee, in particular where large-scale operations are required. They often lend to local banks, which are retailing it to final borrowers. In some countries, the financial support is composed of both credit and guarantee; in other cases, the microcredit is provided without collateral requested to the entrepreneur.

At the Community level, the Multiannual Programme (MAP) for enterprise and entrepreneurship, in particular SMEs (2001-2005) provides a microcredit guarantee window managed by European Investment Fund, which is recognised as an important tool to share the risk of microcredit institutions, so that they can increase their microcredit provision.

5. *Associated guarantee schemes*

Guarantee (co- and counter-guarantee) schemes make it easier for the credit institution to provide microcredit because its risk exposure is reduced and its capital requirement is mitigated.

6. *Traditional and new microcredit institutions*

Since the 19th century, savings banks and co-operative banks have been the main micro-credit providers. The microcredit provided by banks is however not sufficient to match the microcredit demand. In the last two decades, therefore, new private microcredit institutions have been emerging, especially in the Candidate Countries, but also in some Member States, such as France, Spain, and the United Kingdom. Depending on national laws they are limited companies, microfinance institutions, trusts, foundations, charities or non-profit associations, which provide a significant support to business creation.

7. *Technical Aspects*

Micro-lending differs from conventional bank lending in a number of technical aspects. Credit assessment methods used focus more on the borrower and the likely impact of their business on their community than on the business plan. Micro-finance providers generally attempt to reduce or avoid the need for collateral. Step lending techniques, in which larger follow-up loans are provided if the initial loan is successfully repaid, reduce risk and transaction costs. The maturity period is normally short and the interest rate often relatively high compared to traditional bank loans.

8. *Interest rate pricing policy by private microcredit institutions*

A soft loan approach in force in several Member States denies private microcredit institutions the possibility to become sustainable and therefore independent of public subsidy: this approach is therefore of limited relevance, in particular, in the light of the current situation of low inflation rate and low base rate of the European Central Bank. A market driven approach will allow all costs to be gradually covered and make the private micro-lending activity self-sustainable (or self-sustainable as quick as possible). In this regard, the usury rate ceiling enforced in certain Member States denies financial institutions the possibility of providing micro-financing to risky business creators and constitutes a barrier to entrepreneurhip and self-sustainability of the private microcredit activity. Overall, the main issue for business creators and existing small entrepreneurs remains the access to finance, not the interest rate.

9. *Business support services*

In addition to microloans, the provision of non-financial services, in particular mentoring, is essential to increase the chance of survival of start-ups and small enterprises. Coherence and co-ordination with financial institutions are important aspects in order to get appropriate business support services.

9.2 Recommendations

9.2.1 Strengthening European and national partnerships in micro-finance

The European Commission is invited to:

1. increase the budget of the SME guarantee facility provided by existing MAP financial instruments, which mainly benefits business creators and micro-enterprises with less than ten employees;
2. encourage ERDF and ESF to promote microcredit activities based on existing good practices, in particular in Candidate Countries;
3. report on best practices about guarantee and MGS;
4. up-date best practices and the analysis of market gap in microcredit in 2005-2006 by assessing regular progress made in microcredit provision, in particular in the Candidate Countries.

9.2.2 Enabling environment and public support

The Member States are invited to:

1. improve the legal framework and adopt an enabling environment in order to facilitate fund raising by microcredit institutions and microcredit provision for new or existing small enterprises. Where appropriate, an assessment of the impact of the usury rate on any kind of enterprise should be carried out;
2. consider self-sustainability as a major objective of a microcredit activity. The intensity of public support to microcredit should be degressive, based on achieved performance and adapted to the targeted businesses. The operational sustainability of the microcredit scheme should be assessed, show regular progress and respect a schedule agreed by the public authority and the microcredit institution;
3. strengthen the co-operation between micro-finance institutions and business support services for small enterprises, as well as consider technical assistance and training on microcredit between promotional banks;
4. assess the performance of MGS in order to facilitate access to finance in the context of Basle II.

9.2.3 Assessing microcredit institutions performance and management quality

The microcredit institutions are encouraged to:

1. assess their performance through regular monitoring, according to clear targets and schedule, and disclose external periodical evaluation of their microcredit scheme based on recognised indicators[86];
2. exchange views on the quality of the credit decisions and the adequacy of reserving policies. Increase transparency, in particular, enhance on reporting and converge on the definitions of past due, non-performing, and defaulted loans. Sometimes, there are also differences in provisioning and write-off policies. To allow meaningful comparisons, the improvement of public disclosures in this regard would be useful;
3. develop synergies with business support services;.
4. adopt appropriate ex ante and ex post risk management procedures, in particular quick and cheap simplified scoring systems composed of qualitative and quantitative aspects, as a way of reducing microcredit handling costs, one of the main obstacles to microcredit provision.

[86] Indicators such as default rate, loss rate, public support intensity, operational sustainability, financial sustainability, micro-enterprise survival rate, number of beneficiaries, loan size average and job creation by microcredit are useful to assess the performance of a microcredit scheme.

ANNEX 1
Comparison of products offered by: Banque du Développement des PME, Finnvera Plc. and KfW

	KfW : StartGeld	**FINNVERA : Microloans**	**BDPME : P.C.E.**
Loan Amount Min. Max.	 --- EUR 50,000	 EUR 3,400 EUR 35,000	 EUR 3,000 EUR 8,000
Term	Up to 10 years, of which up to 2 redemption-free years	5 years, of which 1 redemption-free year	5 years, of which 1 redemption-free year
Interest rate	Fixed interest rate	Variable interest rate (based on the 6- month Euribor)	Fixed interest rate
Loan proceeds disbursed	96%	98%	100%
Processing fee	House bank receives a fixed processing fee of EUR 500 from KfW	1.5% of the loan amount, min EUR 92 for Finnvera (payable by the customer)	Business support and advice bodies receive a fixed processing fee of EUR 305 from BDPME
Collateral	Collateral,where available, to be given The house bank is granted an 80% exemption from liability	Generally, no collateral required In the case of legal forms with limited liability, the personal guarantee of the entrepreneur is required.	No collateral necessary for P.C.E. For the complementary loan, the house bank may use as security backing any existing sound collateral within the framework of the project which is to be financed. In addition, BDPME can provide a guarantee of 70% for this house bank loan.
Interest rates	7.30% p.a. nominal 8.40% p.a. effective (interest rate for 10 years)[87]	**Microloans** 4.76% p.a. nominal (3.256 Euribor + 1.5%) 5.34% p.a. effective **Loans to women** 4.26% p.a. nominal 4.82% p.a. effective (3.256 Euribor + 1.0%) Finnvera receives a special interest subsidy of 3% paid by the state on the basis of the portfolio. **In objective 1 or 2 areas** Microloans 2.76% p.a. (3.256 Euribor – 0.5%) Loans to women : 2.26% p.a. (3.256 Euribor – 1.0%)	5.88% p.a. nominal. 5.96% p.a. effective (interest rate for 5 years).

Source: NEFI, Business segment microloans, January 2002.

[87] July 2003 : 6.10% nominal ; 7.09% effective.

ANNEX 2
Microcredit report: Working Group members

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ANNEX 3

Glossary

Bank

A bank is a credit institution defined as such by the 3rd Banking EU Directive (2000/12/EC of 20 May 2000, OJ L 126 26 May 2000), and therefore includes savings banks and co-operative banks, and among the latter credit unions. A bank is under public banking supervision.

Collateral

The collateral is the security given by a borrower to a lender as a pledge for the repayment of a loan. This could include certain financial securities, such as equity or debt securities, real estate or compensating balance. A compensating balance is the minimum amount of a loan that the borrower is required to keep in an account at the bank.

Covenant

A covenant is an agreement or stipulation in loan contracts, particularly contracts with enterprises, by which the borrower either pledges to take certain action (an affirmative covenant) or to refrain from taking certain action (a negative covenant), and is consequently part of the terms and conditions of a loan.

Credit line (or overdraft)

A credit line is a facility with a stated maximum amount, which an enterprise is entitled to borrow from a bank at any given time.

Credit standards

Credit standards are the internal guidelines or criteria, which reflect a bank's loan policy. They are the written and unwritten criteria, or other practices related to this policy, which define the types of loan a bank considers desirable or undesirable, the designated geographic priorities, the collateral deemed acceptable and unacceptable, etc.

Credit terms and conditions

The terms and conditions of a loan refer to the specific obligations agreed upon by the lender and the borrower. In the context of the report, they consist of the direct price or interest rate, the maximum size of the loan and the access conditions, and other terms and conditions in the form of non-interest rate charges (i.e. fees), collateral requirements (including compensating balances), loan covenants and maturity (short versus long-term).

Enterprises

Enterprises refer to non-financial corporations, i.e. all private and public institutional units, whatever their size and legal form, which are not principally engaged in financial inter-mediation but rather in the production of goods and non-financial services.

Guarantee

A guarantee is the transfer of a risk to a third party, the guarantor.

A loan guarantee is the promise by a guarantor to pay the loan if the borrower does not repay.

For a lender, it therefore can lend without taking into account the risk taken by the guarantor.

For the borrower, the guarantee helps securing finance, which would not have been possible otherwise or it would have received under less favourable conditions.

To defray its possible losses, the guarantor ask for a risk-adjusted guarantee fee: guarantee premium or risk premium.

A counter-guarantee is a financial instrument, which allows the guarantor to share the risk with another guarantor. The provider of the counter-guarantee accepts a portion of the risk from the guarantee originator and typically receives a portion of the guarantee fee in return.

Loans

The loans covered by the report are those granted to EU and Candidate Countries enterprises by domestic branches, excluding credit lines or overdrafts to enterprises, loans to households for house purchase, and consumer credit and other lending to households.

Maturity (or tenure)

The concept of maturity used in the report is original maturity, and only three different types are used, i.e. short-term, medium-term and long-term. Short-term loans are loans with an original maturity of 3 years or less; medium-term loans are defined as loans with an original maturity of more than 3 years and less than 5 years; long-term loans are defined as loans with an original maturity of more than 5 years.

Non-banks

In general, these consist of non-monetary financial corporations. More specifically, for the purposes of the report, they include limited companies, trust, charities, foundations and associations providing microcredit.

Non-interest rate charges

These are various kinds of fees which can be part of the pricing of a loan, such as commitment fees on revolving loans, administration fees (e.g. document preparation costs) and charges for enquiries, guarantees and credit insurance.

Retailer

For the purposes of the report, a retailer is a financial institution, on the one hand, raising funds from the capital market, investors, a state-owned promotional bank or a traditional bank and, on the other hand, assessing the credit application and deciding to award a loan directly to an individual enterprise. Sometimes, the state-owned promotional bank or the traditional bank providing funds to an institutional customer (the retailer) is defined as a "wholesaler".

This expression could however be misleading because for the banking industry, in general, "wholesaling" is the corporate activity and "retailing" the SMEs' activity carried out by a same bank.

SME

The EC recommendation C(2003)1422 of 6 May 2003 gives new thresholds to SME categories :

SME category	Headcount (unchanged)	Turnover p.a.	Balance sheet total p.a.
Medium-sized	< 250	< €50 million (in 1996: <€40 million)	< €43 million (in 1996: < €27 million)
Small	< 50	< €10 million (in 1996: <€7 million)	< €10 million (in 1996: < €5 million)
Micro	< 10	< €2 million (previously not defined)	< €2 million (previously not defined)

In Community law, this new SME definition will replace in 2005 the Commission Recommendation 96/280/EC (OJ L 107 of 30 April 1996).

Sustainability ratios

For the purposes of this report, two ratios have been selected:

- Operational sustainability = income from clients/(refinancing costs + credit losses + administrative expenses);

- Financial sustainability = income from clients/(refinancing costs + credit losses + administrative expenses + cost of own fund).

ANNEX 4
Abbreviations

ADIE	Association pour le Droit à l'Initiative Economique
AECM	Association Européenne du Cautionnement Mutuel
ANDC	Associação Nacional de Direito ao Crédito
APCE	Agence pour la Création d'Entreprise
APR	Annual Percentage Rate
AWS	Austria Wirtschaftsservice GmbH
BAFin	Bundesanstalt für Finanzdienstleistungsaufsicht
BDPME	Banque du Développement des Petites et Moyennes Entreprises
BS	Business Support
BüBa	Bürgschaftsbank
CC	Candidate Countries
CDFA	Community Development Finance Association
CDFI	Community Development Finance Institution
CEB	Council of Europe Development Bank
CERSA	Compañia Española de Reafianzamiento, S.A.
CESGAR	Confederación Española de Garantía Recíproca
CGAP	Consultative Group to Assist the Poorest
CITR	Community Investment Tax Relief
CONFIDI	Consorzio di Garanzia Collettiva Fidi
DEG	Deutsche Investitions und Entwicklungsgesellschaft mbH
DG	Directorate General
DtA	Deutsche Ausgleichsbank
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
EIF	European Investment Fund
EMN	European Micro-finance Network
ENSR	European Network for SME Research
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EW	Equity Window
FEDART	Federazione Nazionale Unitaria dei Consorzi e delle Cooperative Artigiane di Garanzia
FdP	Fonds de Participation
FS	Financial Sustainability
GDP	Gross Domestic Product
ICO	Instituto de Crédito Oficial
ICOF	Industrial Common Ownership Finance
IFC	International Finance Group (World Bank Group)
IFIs	International Financial Institutions
IMF	International Monetary Fund
IMI AG	Internationale Micro Investitionen Aktiengesellschaft
INAISE	International Association of Investors in the Social Economy
IRB	Internal Rating Based
KfW	Kreditanstalt für Wiederaufbau
LEA	Local Enterprise Agencies
LGLW	Loan, Guarantee and Leasing Window
MAP	Multi Annual Programme for enterprise and entrepreneurship, in particular SMEs (2001-2005)
MCC	MedioCredito Centrale

MCP	Micro Credit Programme
MFC	The Microfinance Centre for Central and Eastern Europe and the New Independent States
MGS	Mutual Guarantee Schemes
MS	Member States
MVA	Magyar Vállalkozásfejlesztési Alapítvány
n.a.	not available
NEFI	Network of European Financial Institutions
NGO	Non-Governmental Organisation
NIS	New Independent States
NMCF	National Micro Credit Fund
OECD	Organisation for Economic Co-operation and Development
OJ	Official Journal
OS	Operational Sustainability
p.a.	per annum
PCE	Prêt à la Création d'Entreprise
SBGF	success based loan guarantee fund
SME	Small and Medium Enterprise
SMEVCLF	Small and Medium Enterprise Venture Capital and Loan Fund
SNCI	Société Nationale de Crédit et d'Investissement, Luxembourg
SOCAMA	Société de Cautionnement Mutuel des Artisans
SP	Standard & Poor's
UK	United Kingdom
USAID	United States Agency for International Development