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Banks and Micro-lending

Support,

Co-operation

and Learning

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In recent years there has been growing interest in micro-lending among bankers, governments and those involved in area regeneration initiatives or working with unemployed people. Micro-lending involves issuing small loans to micro-enterprises who are considered to be a very high risk and/or very costly to serve in commercial banking terms. Definitions of micro-lending vary, usually according to the size of the businesses that are eligible for loans and the amount of money they can borrow. For the purposes of this study micro-lending is defined as loans of between 1,000 and 25,000 EUROs to people running business with less than five employees.

Micro-entrepreneurs face a number of significant, and often insurmountable, obstacles in gaining access to appropriate finance. Similar issues were raised by entrepreneurs in all four of the countries involved in the research, although the extent of the problems they encountered varied between the countries. The main problems experienced by micro-entrepreneurs fell into three categories:

- psychological obstacles;
- practical obstacles;
- inappropriate loan products.

Despite the difficulties of making credit available to entrepreneurs, experience shows that many can, with appropriate finance and support, establish viable businesses and repay loans.

Micro-lending organisations can help bridge the finance gap by lending to micro-enterprises who cannot get a loan from a bank. However, micro-lenders – using the techniques they have developed to enable them to lend in such a risky market – could also help banks learn how to distinguish between micro-enterprises that are likely to be successful and those that are not. They can also share the experience they have developed in lending to these customers, and the loan products and packages of support that are most appropriate in this market. In doing this, drawing on the experience of micro-lenders could help banks to extend their loan portfolios to include micro-enterprises with the potential to succeed.

It is important to recognise, however, that just as it is not always appropriate for micro-lenders to lend instead of banks, neither would we advocate banks lending in this market instead of micro-lenders. In fact, there is a whole range of ways that banks can be involved with micro-lenders and, further, can benefit from these relationships. Evidence suggests that these partnerships can bring valuable returns to banks – both financial and non-financial. This report aims to demonstrate the main forms of co-operation between banks and micro-lenders and help banks to determine what is most suitable for them and their clients.

About the research

The research project *'Benchmarking in micro-lending: working towards best practice'* is led by the Institute for Financial Services (iff) in Hamburg, Germany and co-financed by the DG XXIII of the European Commission. The other project partners are:

- the Personal Finance Research Centre (**pfrc**) in Bristol, UK;
- the Centre for Alternative Social Analysis (CASA) Copenhagen, Denmark;
- FACET, Zeist, the Netherlands.

This report was produced by **pfrc** in co-operation with iff.

Executive summary and conclusions

The overall objective of this research was to benchmark micro-lending initiatives in Europe and elsewhere, identify best-practice and identify ways of reducing the costs and risk associated with lending to micro-entrepreneurs. The final stage of the project was to use the research findings to facilitate new and exciting micro-lending initiatives with a series of practical outputs. The first of these, a handbook for micro-lenders, distils best practice in relation to reducing the costs and risks associated with lending in this market. This second report is aimed at people working in the commercial banking sector.

The report is informed by this research and by a seminar held with seventeen representatives of European commercial banks to discuss its findings. It distils their experiences of micro-lending from a commercial banking perspective. It aims to be of use to bankers in two key ways. First, by describing the range of ways that commercial banks can co-operate and work with micro-lenders to assist micro-entrepreneurs. Second, by identifying some of the ways that micro-lenders have tackled cost and risk reduction that may have some relevance for banks wanting to extend their own lending in the micro-enterprise market.

What has micro-lending got to offer?

The term micro-lending is used to describe a range of different types of organisation, offering loans to a broad range of clients who could not, otherwise, obtain funding through commercial banking sources.

The obstacles facing micro-entrepreneurs in gaining access to appropriate finance mean that three main types of client tend to be seeking help from micro-lending organisations. These are:

- *socially excluded people,* entering marginal self-employment;
- people in or beyond the start-up phase with *micro-credit needs;*
- people running existing micro-enterprises in need of *development capital.*

The first group are generally in need of social credit, offered as part of a package of support and after-care that will enable them to cope with the process of applying for funds, setting up a business and managing a going concern. People with micro-credit needs generally have a good and well-developed idea or are already running a business, but are not bankable in commercial terms, either because they are considered too risky, or because the loan products available from commercial banks are inappropriate. Finally, people seeking development credit have needs that correspond much more closely to the products that are available in the mainstream market but their needs still cannot quite be met because they cannot convince a commercial bank that they are credit worthy.

There is no single model of micro-lending and organisations vary in terms of their scale and methods of working. A number of factors influence the style and structure of micro-lending organisations, including the social, economic and legislative context that they operate in and the type of clients that they aim to serve.

In the main, micro-lenders are distinct from commercial banks in terms of their small loan sizes, quick and easy access and their non-commercial credit worthiness assessments and collateral requirements. There are also a number of other specific differences, including:

- the institutional setting;
- loan products;
- marketing and client acquisition;
- risk assessment; and
- risk management.

Executive summary and conclusions

Although commercial banks have raised a number of objections to becoming more involved with micro-lenders, interviews with bankers who are involved with micro-lending organisations have identified a range of social, political and commercial benefits.

Many banks already support micro-lending schemes and do so in a wide variety of ways, these are described below and in more detail in Chapter 3. Some banks with a long-standing involvement with micro-lending organisations recognise that there are important lessons that banks can learn from micro-lenders that would enable them to extend their own customer base. These are also covered below and are discussed in more detail in Chapter 4.

Banks and micro-lenders: working together

Banks can develop three types of relationship with micro-lenders. First, they can set up, and outsource all their micro-lending business, to a specialist organisation designed specifically for this purpose. Second, they can co-operate with and support micro-lending organisation in a variety of ways. Third, commercial banks can learn from micro-lending techniques in order to develop their own lending in this high risk market. Both the motivation for banks becoming involved with micro-lenders, and the nature and extent of this involvement will be determined by the aims of the micro-lending scheme and its client group.

Outsourcing

One strategic option for banks that decide it is uneconomic for them to try to offer social credit to people entering marginal self-employment is to create new companies, set up specifically to work with this target group. This can be an effective strategy where banks are under social or political pressure to respond to needs for credit that are incompatible with their ethos and working style. It can also be an extremely effective method of initiating a relationship with people that they cannot help at the moment but who could, in the future, become valuable clients.

Outsourced micro-lending activities tend to develop in two main ways. First, focussing on providing social credit to finance start-up activities among clients who tend to be most disadvantaged in relation to, or completely excluded from, financial services. Second, if the bank's main goal is to develop their own lending provision in an area that has previously been perceived as uneconomic, outsourcing should target the entrepreneurs that are not bankable because they have micro-credit needs.

Co-operative arrangements

There were many examples of very constructive forms of co-operation between banks and the benchmarked micro-lenders and it is clear that working with micro-lenders need not be a one-way relationship. There are five broad ways that banks have supported micro-lending schemes:

- financial assistance;
- management and staffing;
- loan decision-making and administration;
- client support and practical assistance; and
- client referral.

Executive summary and conclusions

The striking thing about talking to bankers about their relationships with micro-lending organisations is how positive they are about these arrangements. While they may have begun co-operating with micro-lenders out of philanthropic intentions they have, at least in the UK and the US, begun to recognise the benefits that banks can reap from doing so. Not only can micro-lenders and banks develop very constructive, mutually beneficial relationships but their clients can become very profitable customers for mainstream banks. A representative of Barclays Bank noted that as their relationship with micro-lenders developed, it was less and less about donating money and increasingly about forging a mutually beneficial partnership. The advice of a representative of the Cambridge Savings Bank, which works closely with Working Capital, to other banks who may be thinking of getting involved with micro-lending was, *'It's worth the risk. it is profitable for the bank because these people are coming back'.*

Learning from micro-lenders

Not every bank will want to lend in the high-risk micro-enterprise market. But for those that do, there are some interesting lessons from the experiences of specialist micro-lenders on how to lend in this market without incurring unacceptably high costs or running the risk of high rates of default.

Loan products

A wide range of tailor-made loan products have been designed to meet the needs for risky micro-entrepreneurs. These include stepped loans, where borrowers are, effectively, assessed for a credit line, which is delivered as a series of small short-term loans, with each loan being conditional on the borrower's repayment history. These reduce the risk faced by both borrower and lender alike.

Fixed repayment loans, where no penalties are imposed for default but are allowed for in the interest rate and general charges, are a key element for some micro-lenders. But they are by no means universal. Micro-lenders that issue such loans find that they do not increase the level of default and have a positive effect on business survival rates.

On the whole, borrowers at this end of the market are prepared to pay higher interest rates – but only for products tailored to their needs. Most micro-lenders do not require security for the loans that they issue and those that do require more on loan guarantees than other forms of security. On the whole, though, they prefer to reduce the risks of lending instead.

Although group lending is often considered to be synonymous with micro-lending, it is only used by a minority of micro-lenders in Europe and the United States. Lending in this way can reduce the costs of payment collection and reduce the level of default through peer pressure.

Business support

There is a clear need for customer support as well as loans. Although whether or not this should be provided from the same institution is a matter of debate. People entering marginal self-employment often need extensive support and mentoring; while new and existing entrepreneurs have needs ranging from advice and training to detailed consultancy.

Marketing

Attracting suitable clients is by no means easy, as many micro-lenders have found. On the whole the most successful strategies have been based on using other entrepreneurs to introduce new customers.

Risk assessment

Risk assessment is, perhaps the main area where there are important differences between banks and specialist micro-lenders. In general, risk assessment is based much more on personal factors such as entrepreneurs commitment to their business and their business cash flow than it is on business plans. Indeed, some micro-lenders have developed some very sophisticated systems of risk assessment, that differ markedly from those used in bank small business lending.

Managing risk

Micro-lenders have developed a range of interesting techniques for managing risk. These include loan after-care, designed increase business survival rates. Incentives for prompt payment (e.g. entitlement to further loans; future loans at a reduced interest rate) have generally been found more effective than penalties for late payment. Finally, all successful micro-lenders operate a firm but fair approach to debt management. Many have had to learn this lesson the hard way, after incurring high rates of default. Some expect repayments to be made at a set time and place and contact borrowers within 24 hours of late payment. Where there is a genuine reason for non-payment loans are rescheduled; where there is not then immediate steps are taken to recover the money owed.

Levels of default and financial self-sufficiency

By using such techniques levels of default are contained to under 10 per cent, while at the same time, organisations specialising in micro-credit or development loans had achieved between 41 and 116 per cent operational self-sufficiency.

Executive summary and conclusions

The research and seminar suggest that there are three main ways that a bank can work with a micro-lending organisations to support and develop lending facilities to micro-entrepreneurs. They can:

- set up a separate micro-lending organisation, subsidised by the bank but operating at arms length from it (see Chapter 3);

- co-operate with micro-lending organisations in a variety of ways to increase their capacity and effectiveness (Chapter 3);

- develop their ability to lend directly to micro-entrepreneurs by employing some of the techniques used by micro-lenders (Chapter 4).

Several of the bankers that attended the seminar on micro-lending held in London in September 1999 recognised that these three approaches need not be mutually exclusive. In fact, one expressed the view that the key to success was to be pragmatic and, where appropriate, employ more than one of the above strategies. Another stressed that there was no 'blue print' to working with micro-lenders, and it is important to develop working relationships that suit all the parties involved.

There was an acknowledgement that supporting micro-lending was not about meeting all the needs of micro-entrepreneurs, but 'moving down the scale' so that, where it was feasible, more of their needs could be met by banks. In this respect, working with micro-lenders could enable commercial banks to cross boundaries that had previously restricted their lending activities in this area.

The participants concluded that the seminar had provided them with four key insights into the issue of working with micro-lenders. First, a clearer picture of the needs of micro-lenders' clients. Second, a recognition that access can be more important than price in relation to micro-credit. Third, an understanding of the wider, non-financial benefits of working with micro-lending organisations. Finally, a confirmation of the importance of strategic working relationships.

Understanding clients

Bankers felt that one of the most valuable outcomes of the research and seminar was the categorisation of micro-lenders' clients according to their requirements for social credit; micro credit; or establishment credit. This typology was particularly powerful because of its influence on the structure and operation of micro-lending organisations. Bankers felt that understanding this typology would be instrumental in helping them:

- decide whether and how to work with micro-lending organisations;
- recognise which type of organisation was most compatible with their organisational goals; and
- understand the likely outcomes of working with different types of micro-lenders.

Some felt that, armed with this insight, they could draw up a checklist of questions to ask any micro-lending organisations they were thinking of working with to ensure that both the bank and the micro-lender would benefit from the partnership.

Price versus access

Another valuable outcome of the research and seminar, from the bankers' viewpoint, was discovering that, for micro-entrepreneurs, the cost of a loan is less important than being able to gain access to appropriate credit. Demand and take-up for this type of credit is much less price sensitive than is the case with other loans.

Many bankers felt that despite the fact that the costs and risks of lending to them are higher, charging more vulnerable customers, like micro-entrepreneurs, a higher price for loans would be politically unacceptable. While micro-entrepreneurs should not be charged a higher price for the same credit facilities as other entrepreneurs, they are prepared to pay more for tailor-made products if these are more costly for banks to provide. In this context, it is clear that money spent on subsidising the cost of loans for micro-entrepreneurs could, potentially, be better spent elsewhere.

The non-financial rewards

The director of the British Bankers' Association, who chaired the seminar, highlighted the importance of recognising that the commercial rewards of working with micro-lenders do not necessarily equate to financial returns. In the context of a growing emphasis on social responsibility among financial institutions in Europe and the United States, where the issue of access to credit facilities for micro-entrepreneurs has become the focus of much political attention, commercial gain must be defined more widely than simply as profit. Working with micro-lenders could enable a commercial bank to build, and protect, their license to operate as well as enhance their reputation and extend their market. Equally, in a highly competitive industry, social goals may have a commercial value, and being able to demonstrate 'corporate citizenship' could provide an important competitive edge.

Strategic working relationships

Bankers felt that the research and seminar confirmed that, like all working relationships, support for micro-lending must be strategic rather than static. For example, one-off grants to micro-lenders providing social credit to the marginally self-employed, that are not aiming to be self-sustainable, does not provide them with the stability or continuity they need to develop. Similarly, co-operating with a micro-lending organisation by providing seconded staff that do not return to the bank to share the knowledge and expertise they have acquired does not help the bank to develop their own approach to micro-credit. Ongoing, strategic relationships between commercial banks and micro-lenders must be based on a shared view of the desirable outcomes for each party.

In addition, partnerships between banks and micro-lenders should recognise the need to provide ongoing support to micro-entrepreneurs. If banks and micro-lenders are to reap the benefits of lending to successful enterprises, as well as bear the costs and risks associated with lending to those who are unsuccessful, they must ensure that their products and working style are adaptable to the needs of micro-entrepreneurs throughout their working lives.

1 Introduction

In recent years there has been growing interest in micro-lending among bankers, governments and those involved in area regeneration initiatives or working with unemployed people. Micro-lending involves issuing small loans to micro-enterprises who are considered to be a very high risk and/or very costly to serve in commercial banking terms. Definitions of micro-lending vary, usually according to the size of the businesses that are eligible for loans and the amount of money they can borrow. For the purposes of this study micro-lending is defined as loans of between 1,000 and 25,000 EUROs to people running business with less than five employees.

Much of the recent interest in micro-lending is predicated on the strong belief that supporting micro-enterprise is essential for economic and social progress and, in particular, to provide employment opportunities and reduce levels of unemployment. This view was especially powerful in the period immediately after the most recent recession, which affected many European states. As a result, a number of state-funded initiatives were created to encourage and facilitate people with limited employment opportunities to create their own jobs by setting up a business.

In the United Kingdom (UK), for example, successive governments have introduced a range of policies to encourage people from unemployment into self-employment. Currently, there are two main government programmes to help the self-employed and small businesses locate an appropriate source of finance. These are the Training and Enterprise Councils (TECs) in England and Wales and the Local Enterprise Companies (LECs) in Scotland, and the Business Links scheme. Both of these initiatives operate nation-wide and work in co-operation at local level.

In the Netherlands there is a range of state-funded bodies offering loans and loan guarantees. In addition, the Dutch welfare benefits system allows individuals who set up micro-enterprises to continue receiving benefit income from the municipal social services department, up to a maximum of their unemployment benefit entitlement, for their first eighteen months of operation.

In the early 1990s, when unemployment levels in Denmark were particularly high, the government introduced a number of initiatives to encourage the jobless to set up their own businesses – the two most important were schemes providing an additional source of income for people who had moved into self-employment. In recent years, however, there has been a change of policy in this area and in 1998 the self-employment income scheme was abolished.

While these schemes have, undoubtedly, increased the number of people who have become micro-entrepreneurs, the rapid growth in the number of people setting up businesses because they are unemployed or have unstable employment prospects has created a new set of problems. Some micro-entrepreneurs face a serious 'finance gap' in gaining access to the credit they need to set up, or support the running of, their business. This is largely because the people attracted to micro-enterprise in this way are not, generally speaking, the most creditworthy. In addition, they are unlikely to have any start-up capital of their own and, therefore, need to seek 100 per cent funding from outside sources. Yet, while their needs for credit are, perhaps, greater than is the case with small- or medium-sized enterprises, their requirements are not easily met, either by commercial bank lending or by government loan guarantee schemes.

It is important to recognise, however, that many commercial banks in Europe can and do make micro-loans. The loan profile of the National Westminster Bank, for example, shows that it is, arguably, the biggest 'micro-lender' in the UK. Nevertheless, there is a good deal of evidence that certain groups of micro-entrepreneurs in Europe find it difficult to gain access to bank funding. Country reports produced for the UK, Germany, Denmark and the Netherlands indicate that the worst affected groups are people entering self-employment from unemployment, young people, women, people from minority ethnic groups, and semi- and unskilled people.

Micro-entrepreneurs and business finance: the obstacles

Micro-entrepreneurs face a number of significant, and often insurmountable, obstacles in gaining access to appropriate finance. Similar issues were raised by entrepreneurs in all four of the countries involved in the research, although the extent of the problems they encountered varied between the countries. The main problems experienced by micro-entrepreneurs fell into three categories:

- psychological obstacles;
- practical obstacles;
- inappropriate loan products.

Psychological obstacles were found to be worst in the UK, followed by Germany, and less problematic in Denmark and the Netherlands. Practical obstacles were, again, worst in the UK, but the situation in the other three countries was not a great deal better. Finally, the extent of the problems caused by inappropriate loan products was similar in all four countries, although the exact nature of these difficulties varied.

Psychological obstacles

Psychological obstacles seem to stem from a number of factors. First of all, the image of many commercial high street banks is very daunting for some groups of people, particularly those who are not used to dealing with financial institutions or who have little or no business experience. In addition, many people feel that banks do not value customers who have very small, low-profit businesses or who want to borrow small amounts of money. This is especially the case in the UK, where the business banking sector is dominated by the 'Big Four' high street banks. Psychological obstacles are also apparent in the Netherlands, however, where banks are housed in large, prestigious buildings and meetings take place in very luxurious, and imposing, offices.

Micro-entrepreneurs may also be deterred from approaching a commercial bank for finance by a lack of understanding of the procedures involved. They do not know what to expect and, consequently, find it difficult to prepare themselves for the meeting in advance. This problem can be compounded if the application process becomes protracted, because they cannot provide adequate information to support their application on the first visit or, worse, if their application is refused because they are unprepared. Many micro-entrepreneurs in these circumstances may be unwilling to persevere with their application or to approach a different institution. And many are deterred from applying in the future.

In addition, micro-entrepreneurs often perceive their relationship with formal credit institutions to be very unequal. In the Netherlands, for example, people spoke of 'feeling like a beggar' when they approached the bank for a loan. In the UK, it is not unusual for micro-entrepreneurs to feel that they are required to 'defend' their application rather than discuss it in partnership with banking personnel. They also feel that, because they are unlikely to be very profitable customers for the banks, there is more pressure on them to 'prove their worth' to the banks if they are to gain access to credit.

Finally, some people, particularly those who are unused to dealing with financial institutions, are frightened to borrow from a bank in case they are unable to meet the repayments. There is a widespread perception, particularly in the UK, that banks' debt recovery procedures are very harsh and this is extremely off-putting for some micro-entrepreneurs, especially those with little or no business experience who are setting up a brand new venture.

For some micro-entrepreneurs, these factors may undermine their confidence in dealing with the bank and result in a power-imbalance between the bank and the individual. Others, however, may be put off approaching a commercial bank for finance altogether.

Practical obstacles

The practical requirements associated with making a loan application to a commercial bank can cause particular problems for some micro-entrepreneurs once they have taken the step of approaching the bank. Again, these problems are most significant for people who have little engagement with financial services and who are inexperienced in business matters.

The amount and nature of the paperwork required to support a loan application can be very daunting, especially for those with a poor educational background. In addition, some people are unable to provide information such as spending forecasts and cashflow projections that commercial banks need in order to assess the application. Similarly, putting together a polished and viable business plan can be an insurmountable problem for people with little or no business experience.

Many micro-entrepreneurs plan to set up, or are already running, businesses that are home-based – offering services such as sewing, cooking or hair-dressing – or are quite informal – such as window-cleaning. Because banks have relatively little experience of dealing with businesses of this sort, it can be very difficult for micro-entrepreneurs to convince banking personnel that their proposition is viable. People who want to start 'unusual' businesses face similar problems. This is particularly the case for people from minority ethnic groups, who find it difficult to bridge the cultural gap between them and a formal financial institution. It is also often the case for those wanting to set up very innovative, experimental or high-tech enterprises.

Finally, because the process of applying to a commercial bank for credit is so alien to them the application process can be both protracted and time-intensive. Some micro-entrepreneurs, particularly those who are in employment or caring for a family, are unable to invest the time and effort necessary to compile a watertight business plan.

Inappropriate loan products

Even if a micro-entrepreneur can overcome the psychological and practical obstacles associated with approaching a commercial bank for credit they may still have difficulty finding an appropriate loan product. While the commercial banking sector can meet the needs of many small businesses, there are a number of limitations on what they can offer micro-entrepreneurs.

Micro-entrepreneurs are not always cost-effective customers for commercial banks. In particular, the small amounts of money they are seeking to borrow, and the relatively short periods of time over which they want to repay, can be uneconomic when they are set against the transaction costs faced by formal financial institutions in processing the application. In addition, the fairly intensive support required by some micro-entrepreneurs – both before and after their application – adds to the expense of lending to them.

Typical micro-entrepreneurs have few, if any, resources of their own to draw on to fund a business and, consequently, require a bank to provide 100 per cent finance for their enterprise. This presents difficulties for many commercial banks, who prefer customers to put up a proportion of the required funds themselves, as proof that they are serious about the business and as a way of sharing the risk. This is compounded by the fact that most micro-entrepreneurs cannot provide an acceptable form of security for a loan.

These problems can be exacerbated when a bank's small business loan decision-making is centralised. This means that applications are assessed on objective criteria alone and the opinions of individual bank staff cannot influence the outcome. The lack of personal contact between the applicant and the decision-maker means that factors such as personal motivation or determination cannot be taken into account.

Bridging the finance gap

Despite the difficulties of making credit available to entrepreneurs, experience shows that many can, with appropriate finance and support, establish viable businesses and repay loans. For example, on a hypothetical scorecard, out of 10,000 applications for small business loans, around 8,000 might be accepted and 2,000 might be refused. Yet it is likely that around 1,000 of the accepted applications could turn out to be problematic, while 1,000 of the declined applicants might be successful and could have proved a good investment for the bank.

Micro-lending organisations can help bridge the finance gap by lending to micro-enterprises who cannot get a loan from a bank. However, micro-lenders – using the techniques they have developed to enable them to lend in such a risky market – could also help banks learn how to distinguish between micro-enterprises that are likely to be successful and those that are not. They can also share the experience they have developed in lending to these customers, and the loan products and packages of support that are most appropriate in this market. In doing this, drawing on the experience of micro-lenders could help banks to extend their loan portfolios to include micro-enterprises with the potential to succeed.

It is important to recognise, however, that just as it is not always appropriate for micro-lenders to lend instead of banks, neither would we advocate banks lending in this market instead of micro-lenders. In fact, there is a whole range of ways that banks can be involved with micro-lenders and, further, can benefit from these relationships. Evidence suggests that these partnerships can bring valuable returns to banks – both financial and non-financial. This report aims to demonstrate the main forms of co-operation between banks and micro-lenders and help banks to determine what is most suitable for them and their clients.

About the research

The research project 'Benchmarking in micro-lending: working towards best practice' is led by the Institute for Financial Services (IFF) in Hamburg, Germany and co-financed by the DG XXIII of the European Commission. The other project partners are:

- the Personal Finance Research Centre (pfrc) in Bristol, UK;
- the Centre for Alternative Social Analysis (CASA) Copenhagen, Denmark;
- FACET, Zeist, the Netherlands.

This report was produced by pfrc, *in co-operation with iff.*

The overall objective of this research was to benchmark micro-lending initiatives in Europe and elsewhere, identify best-practice and identify ways of reducing the costs and risk associated with lending to micro-entrepreneurs.

The research had a number of stages. First, to identify the national context for micro-lending; assess the level and nature of demand for micro-credit; and map the extent of micro-lending provision in each of the four countries involved in the research – Germany, the UK, Denmark and the Netherlands.

The second stage was to identify and benchmark best practice in micro-lending in Europe and the US. Eight organisations were selected for a more detailed investigation. They were chosen to represent distinctive or particularly successful or innovative methods of working which could inform the future development of micro-credit. The eight organisations were:

- ACCION, New York, United States of America
- ADIE, Paris, France
- Fundusz Mikro, Warsaw, Poland
- Glasgow Regeneration Fund (GRF), Glasgow, United Kingdom
- Industrial Common Ownership Finance (ICOF), Birmingham, United Kingdom
- Women's World Banking (WWB), Madrid, Spain
- Working Capital, Boston, United States of America
- Finnvera (formerly Kera), Finland.

Case study reports of each of these organisations can be found in Appendix 1.

The final stage of the project was to use the research findings to facilitate new and exciting micro-lending initiatives with a series of practical outputs. A key element of this stage was the production of a series of reports, informed by seminars with experts, for use by practitioners. The first of these, a handbook[1] for micro-lenders, distils best practice in relation to reducing the costs and risks associated with lending in this market. This, second, report is aimed at people working in the commercial banking sector.

This report

This report is the result of this research and a seminar held to discuss the findings with seventeen representatives of European commercial banks. It distils their experiences of micro-lending from a commercial banking perspective. It aims to be of use to bankers in two key ways. First, by describing the range of ways that commercial banks can co-operate and work with micro-lenders to assist micro-entrepreneurs. Second, by identifying some of the ways that micro-lenders have tackled cost and risk reduction that may have some relevance for banks wanting to extend their own lending in the micro-enterprise market.

In the following chapter (Chapter 2) we introduce a broad typology of micro-lending organisations – outlining the types of provision and the clients they serve; identifying the key distinctions between micro-lending organisations and commercial banks; and discussing the reasons why banks should become involved with micro-lenders and the benefits of doing so. In Chapter 3 we describe the range of ways that commercial banks can work with micro-lenders. Chapter 4 identifies the areas in which banks could learn from the experiences of micro-lenders. The key themes from these chapters have been brought together in our conclusions that are found at the beginning of the report.

[1] Reducing cost and managing risk in lending to micro enterprises; Handbook for Micro-lending in Europe. Available from the Institut für Finanzdienstleistungen e.V., Burchardstrasse 22, D-20095 Hamburg, Germany. Tel. 0049 (0)40 309 691–10; Fax – 22; Email iff@iff-hamburg.de

2 What has micro-lending got to offer?

The term micro-lending is used to describe a range of different types of organisation, offering loans to a broad range of clients who could not, otherwise, obtain funding through commercial banking sources.

Who are their clients?

The obstacles facing micro-entrepreneurs in gaining access to appropriate finance, outlined in Chapter 1, result in three main gaps in lending provision. These are clearly demonstrated in relation to the types of clients that borrow from micro-lending organisations.

Broadly, micro-lenders' clients fall into three categories:

- socially excluded people who are entering marginal self-employment;
- people in or beyond the start-up phase but still need micro-credit rather than more traditional forms of bank finance;
- people running existing micro-enterprises in need of working or development capital.

What they all have in common is that they have needs for finance that commercial banks cannot meet: because the micro-entrepreneur is not credit-worthy; because banks' small business products are inappropriate; or because the business proposition is considered too risky.

Loans for people entering marginal self-employment

People in this situation are primarily setting up a business as a route out of unemployment. They often have a history of unstable employment and may have been without work for long-periods of time. Some young people in this situation may never have worked at all. They are generally unskilled or have only a very narrow skills base, which restricts their employment opportunities. Most have no business experience and few, if any, relevant business skills.

They tend to be setting up single-person enterprises, usually simply to provide themselves with employment rather than create jobs for other people. Their businesses are often home-based, low-investment/low-return enterprises, offering services such as window-cleaning, car-cleaning or hairdressing. Few have any aspirations for expansion or development and are not aiming for growth.

Bobby is an African-American in his forties. Throughout his working life he has moved from one labouring job to another, earning low wages in insecure jobs. For a number of years he been making leather goods, mostly bags. He heard of Working Capital and through his contact with them he decided he would try to earn a living by making leather bags. But he faced two main problems. First, with his hand operated domestic sewing machine he was limited in the number of bags he could make each week. Second, he was unsure of how to sell more bags even if he could make them. In other words, he needed practical support as well as a loan and encouragement. He did not approach a bank as he was sure he would be turned down.

His first loan from Working Capital, of $500, enabled him to buy a second-hand industrial sewing machine. With this he could quadruple his work output. As a consequence, his income is now way in excess of what he had earned in manual work. He is planning to expand and find premises, rather than work from home. His aspirations are modest, but he would like to employ one or two other people to help sew the bags he designs.

In other words, these clients are seeking **'social credit'** offered as part of a package of support and after-care that will enable them to cope with the process of applying for funds, setting up the business and managing a going concern.

New or existing entrepreneurs with micro-credit needs

This group of clients faces a different set of problems to clients in need of social credit. People in this situation are not necessarily 'pushed' into self-employment as a route out of unemployment. The businesses they set up tend to be less marginal and with a potential for higher returns. In addition, they tend to have a broader skills base and may have some experience of running a business, perhaps informally or as a hobby. While many are lifestyle businesses and are unlikely to be aiming for large-scale expansion, others may have some modest aspirations for growth and development.

Yet while, as a group, they are less marginal than people requiring social credit, their needs are still outside the realms of mainstream lending provision. They generally require only small amounts of money, which are uneconomic for commercial banks to provide. They often want shorter and more flexible repayment than mainstream banks are able to offer. In addition, they are often too risky for commercial banks to lend to, as they have no personal resources to draw on and are unable to provide appropriate collateral to secure a bank loan.

My Hyra had worked as a baker since he was fifteen and, using his savings, had been able to set up his own bakery, in an old city house. The high operating costs associated with his use of old commercial baking ovens and other out-of-date equipment ate away a large proportion of his profits and this prevented him from further developing his business. My Hyra knew he could sell more bread and rolls and felt that the easiest way to increase his revenue would be to open his own shop.

With a loan from Fundusz Mikro he bought and opened his own small shop. He says, 'I finally felt that I had the means to develop my company. I was able to save some money and repair the ovens.' He is now thinking of opening another shop and employing somebody to help him.

This group of clients, then, have a good and well developed business idea but still have **micro-credit** needs, because the loan products available from commercial banks are inappropriate.

Existing micro-entrepreneurs needing working or development capital

This group of clients also faces a particular set of problems. Their businesses are already running and they are in a position to provide information on their accounts and cash-flow forecasts to support a loan application. They may also have viable plans for expansion and development.

However, although they are in a much stronger position than the other two groups of clients, they still find it difficult to find the loan products they need in the commercial banking sector. This may be because they are classed as high risk applicants. Alternatively, they may be unable to convince banks of their ability to repay. Or they may simply have reached their credit limit and, while the bank may be convinced that the business idea is viable, they cannot justify making the loan.

This problem largely relates to the fact that the loans they require are not sufficiently large for banks to justify the transaction costs associated with providing an individual credit-worthiness evaluation. Consequently, they tend only to be offered loan packages involving a standardised credit-scoring procedure. Many micro-entrepreneurs fail this evaluation due to a previous bad credit history, too many address changes or because of factors relating to their personal circumstances, such as the number of children in their household. If these loan applications were to be assessed according to a more sensitive, individually determined, credit-scoring procedure the viability of their proposals might be easier for banks to identify.

Three men in their forties set up a business providing locks and security systems. They subsequently brought in a fourth director who had the marketing expertise they lacked and, soon afterwards, he brought in a large order. The company had a good business plan and a good product, but found it hard to raise the finance they needed to fulfil the order for a number of reasons. None of the partners had any assets to draw on and one of the partners had had a previous business that had failed.

Aston Reinvestment Trust (ART) helped in a four ways. First, they part-funded a loan from their own funds. Second, they arranged for part-funding from Birmingham Enterprise Fund. Third, they persuaded a high street bank to put up the remaining money – almost half of the loan required. Fourth, they arranged for the Enterprise Fund to place someone on the board of the company to help them over the period of development.

With the loan, the company was able to move out of the domestic garage they had been using as their premises, and into premises suitable for fulfilling the order. They were also able to employ an engineer to complement their skills base.

This group of clients needs **development credit,** and their requirements correspond much more closely to the products that are available in the mainstream market. In this respect they are nearly bankable, but their needs still cannot quite be met in the commercial banking sector.

How does micro-lending work?

There is no single model of micro-lending, and organisations vary widely in terms of their scale and their methods of working. It is important to recognise the way that the national context and, in particular, social, economic and legislative differences between countries influence the nature and development of micro-lending. In addition, the type of clients that an organisation aims to target is also a key determinant of its style and the structure of its operations.

Influence of social economic and legislative factors

A number of social, economic and legislative factors can impact on the extent and nature of micro-lending in individual countries. These include:

- government social welfare provision;
- sources of financial assistance for micro-enterprises;
- the structure of the commercial banking sector;
- expectations with regard to service provision;
- national legislation on lending activities;
- support for micro-lending at national level.

Government social welfare provision

Two linked elements of Government social welfare provision can influence the development of micro-lending provision. First, the generosity of state social welfare provision for the unemployed and, second, the extent to which unemployment levels are problematic. If people who are without work have little or no opportunity to rectify this situation, and if government social security provision is insufficient to live on in the long-term, setting up a business could be perceived as the only way of earning a living. As a result, the demand for start-up finance will be high, particularly among high risk groups who have no savings or previous business experience. This situation is likely to stimulate the development of micro-lending initiatives.

This explains the much higher levels of micro-lending activity in countries such as the United States (US), the UK and Poland, than in the Netherlands, Germany and Scandinavian countries where social security is more generous and comprehensive.

Sources of financial assistance for micro-enterprises

The main sources of finance that are available to people who are setting up a business can also determine the type of micro-lending activity that develops. Where support for business has generally taken the form of grants – there is generally very little demand for credit, from any source. However, in countries with a stronger tradition of lending for business start-up and development there is, naturally, more interest in alternative sources of credit.

The commercial banking sector

The way that the commercial banking sector is structured and has developed in each country also has an important impact on the development of micro-lending. In countries like the UK, banking is dominated by a small number of multi-national organisations, often with very centralised decision-making structures. This can result in a much bigger cultural divide between the bank and the individual, particularly those who make little use of financial services.

In Germany and Denmark, on the other hand, there are much larger networks of smaller banks. In particular, there is a greater number of local savings banks. Because these banks have a much smaller customer base than the 'Big Four' banks in the UK, they would argue that they have a better understanding of their needs and how to address them. Consequently, they are less reliant on fixed formulae for dealing with customers and assessing loan applications. This means they are better at coping with 'non-standard' requests for assistance and decision-making can take more subjective factors, such as personal motivation, into account.

As micro-lending initiatives, in general, develop to fill the gap between commercial banks and more micro-business customers they are obviously more prominent in countries where this gap is most significant.

The extent and coverage of government loan guarantee schemes is also of importance in determining the degree to which the commercial banking sector meets the needs of micro-entrepreneurs.

Expectations with regard to service provision

The types of organisations that provide loans for micro-entrepreneurs will also depend on who people expect to innovate, and experiment and provide the impetus for change. In Scandinavian countries, this role has traditionally been played by the state and the voluntary sector has not been particularly proactive. For example, Finnvera who, alongside the commercial banks in Finland, is the major source of funding for micro-enterprise, was founded in 1971 by the Finnish state. While it operates at national level as a 'niche-bank' and works in a very similar way to the commercial banking sector, it is not allowed to compete with the private banking sector.

In countries such as the UK and the US, the state has generally been a conservative force and it is non-governmental organisations and grass-roots activists that people look to for change. ACCION International, for example, was founded in Venezuela as a student-run volunteer effort and, in the US, it is a completely independent non-governmental organisation. In the UK, the Princes Business Trust has an extensive, national network of volunteers who are involved at most stages of the loan-making process.

National legislation on lending activities

The legislative framework, and its provision with regard to lending activities, is a key issue in the way that micro-lending can develop at national level.

Banking law in three of the four countries involved in this research project – Germany, Denmark and the Netherlands – means that only formal banks can issue credit, and non-banking organisations, such as micro-lenders, cannot make any loans themselves at all. This is also the case in many other European countries. In these circumstances, micro-lending can only take the form of facilitating a relationship between formal banks and micro-entrepreneurs – the loans must come from the bank itself.

So, for example, ADIE, in France, concentrates on supporting clients through the loan application process and providing loan guarantees. Although ADIE has received an exemption from this banking law from the Comite de la Reglementation Bancaire, they are still only allowed to make loans from their equity. Similarly, Women's World Bank, in Spain, undertakes all the pre-loan client-support to improve an applicant's chance of success, but once the client is ready to make a formal application to the bank, WWB has no further involvement.

Elsewhere, in the UK, Poland and the US, for example, this is not the case and non-banks can issue loans from their own funds. Consequently, micro-lending initiatives such as ACCION New York, Fundusz Mikro and the Glasgow Regeneration Fund are able to raise loan capital which they lend directly to their clients.

Support for micro-lending at national level

Finally, the context in which micro-lending develops and, in particular, the level and nature of support for it at national level, is also extremely important.

In the UK, for example, there is a great deal of political, economic and academic interest in developing methods of lending to high-risk groups who want to set up in business. This commitment comes from the top and, in May 1998, the UK Prime Minister, Tony Blair identified

'The need to look at how small amounts of credit and capital can be made available for promoting business ideas in Britain's poorest areas... There are promising projects both here and abroad, which show that providing money in the right way makes good business sense as well as strengthening communities.'

In November 1999, the UK government published a detailed report on the needs of micro-entrepreneurs[1] and several expert seminars have been held at Downing Street to discuss issues relating to its development. Industry-level concern about the banking needs of small entrepreneurs has also been stimulated by the Bank of England annual reports on small business lending. Interest in and commitment to micro-lending is apparent – in terms of both policy debate and practical support – throughout the banking sector in the UK.

This support has clearly facilitated the growth of micro-lending, and initiatives are far more prominent in the UK than elsewhere in Europe.

[1] HM Treasury *Enterprise and social exclusion. National Strategy for neighbourhood renewal. Policy Action Team 3* `www.hm-treasury.gov.uk/docs/1999/pat3.html` (20. 03. 2000)

The importance of the client base

The type of clients that a micro-lending organisation aims to attract will also be an extremely important determinant of its character and this is clearly apparent among existing initiatives. The needs of the three groups of clients outlined above, and the services they require from micro-lenders are outlined in Table 2.1.

Table 2.1 – Characteristics of micro-lenders' clients

	Social credit	Micro credit	Establishment credit
typical clients	• trying to find a way into work • no or very limited experience	• in or beyond start up phase • some business experience or business plan • too small, new and risky to be bankable • businesses with modest aspirations for growth	• nearly bankable • want to develop from micro to small firm
Services offered	• grants and subsidised loans • a high level of support and mentoring	• small stepped loans • on the job advice on financial management	• loan packages • co-operation with specialised support agency
organisational examples	ADIE, PBT, Working Capital	ACCION, Fundusz Mikro, Finnvera Micro Loans	ART, Finnvera small firm loans, ICOF

At one extreme, there are a number of micro-lending initiatives created to provide **social credit** to socially excluded groups who are entering self-employment from unemployment. These organisations have clearly developed in such a way as to provide the most appropriate service for this group. They are characterised by extensive pre- and post-loan support mechanisms and play a particularly intensive role in helping their clients to formulate and develop their business idea and funding application. It is also at this end of micro-lending provision that we see the peer group-lending models of micro-lending based on the Grameen Bank in Bangladesh.

ADIE, Paris, France is a good example of this type of micro-lending organisation. ADIE was set up in Paris in 1988, inspired by the Grameen Bank in Bangladesh. Its prime aim is to help people who are excluded from economic activity. However, an important secondary aim is to make them bankable in the mainstream financial sector. ADIE perceives itself very much as a social organisation and does not aim for economic sustainability. It offers two main services to its clients – first, micro-loans at a low rate of interest; and second, an intensive support programme to ensure a high survival rate among business start-ups. Although they do not offer one at the moment, ADIE is planning to introduce a group-lending model for clients from similar backgrounds or particular neighbourhoods.

According to ADIE, an average application takes up 3-4 hours of staff time prior to approval of the loan. The most time-consuming element, however, takes place after the loan has been issued. On average, they estimate that each client receives around 15 hours of support in the two years after they have received a loan. They are contacted by their loan officer on a monthly basis, who checks their progress. Should they encounter problems the loan officer would be directly involved in both dealing with existing difficulties and helping to develop a preventative strategy to avoid future pitfalls.

In 1998, ADIE covered 20-30 per cent of its operating costs from income generated by interest and fees.

Working Capital, Boston, USA already operates a group-lending scheme to increase the economic success of self-employed individuals and their communities by providing loans, business education and networking opportunities to entrepreneurs. Around a quarter of Working Capital's clients live below the poverty line and a fifth were receiving public assistance when they made their application. One of the strengths of Working Capital is the practical help and support that membership brings. In addition to being able to access credit, members are provided with a wide range of other non-financial services, including advice and support; practical help with cash-flow management and business planning; access to free legal advice; and networking opportunities through meetings, seminars and special trade fairs. Interviews with borrowers demonstrate that, for those setting up new businesses, these non-financial services are more important than the loan itself.

However, this intensive non-financial support means that every $1 lent by Working Capital costs $2 to administer. So while they are working towards greater operational efficiency, they recognise that self-sustainability is almost certainly impossible for them to achieve.

In 1998, 20 per cent of Working Capital's operating costs were covered by interest payments and fees.

As well as their very distinctive working style, organisations at this end of the micro-lending spectrum, have a number of other features in common. They cover only a small proportion of their operational costs and, in fact, do not aim to do so (see Chapter 4). Their prime motivation is as a social, rather than a business, organisation. Consequently, they rely on grant-aid for running costs and would be unable to survive without this ongoing financial support.

Despite concentrating on the needs of people who are marginally self-employed, some of their clients do graduate to becoming bankable with commercial financial institutions. Indeed, ADIE has been able to sustain a highly successful loan guarantee scheme for unemployed people moving into self-employment, that offers their banking partners a 70% guarantee. Default rates are just 6 per cent.

Further along the micro-lending spectrum there is a range of organisations that operate more like commercial banks in that they are predominantly lending institutions. They tend to deal with fewer, if any, clients that are seeking social credit. Their clients are more likely to be entrepreneurs with **micro-credit credit needs.** Some of these micro-lenders, such as ACCION New York and Fundusz Mikro believe that financing businesses that are already in operation, however new they may be, is both less risky and less costly than investing resources in business ideas. However, their work is still socially valuable as existing micro-enterprises face a similar problems in accessing credit as micro-business start-ups.

While supporting clients with their loan applications is still a priority, they tend not to require as intensive help as socially excluded clients. Many of these organisations are aiming for, at least, operational self-sufficiency and are, therefore, less dependent on grant-aid. They tend to specialise in lending and do not offer client support services themselves. Their interest rates are often higher than micro-lenders specialising in social credit, and default rates are also generally lower (see Chapter 4). All these factors contribute to a more sustainable revolving loan fund.

Fundusz Mikro (FM), Poland, is a limited liability company, wholly owned by a not-for-profit organisation, and was established under the 1989 Support for Eastern European Democracy Act in the USA. While they are a socially motivated organisation, their objectives relate far more to the practice of micro-lending than to supporting particular groups of people. They aim to be the premier micro-lending organisation in Poland and one of the leading micro-lenders in the world. They also aim to contribute to the advancement of the micro-lending industry. In addition, each year they work towards a number of more operationally oriented goals, aiming at short- and longer-term operation and financial sustainability. In fact, FM reached operational sustainability in Spring 1999 and, according to their plan, full financial sustainability could be achieved within two years.

Fundusz Mikro is structured much more along the lines of a formal bank than most other micro-lenders and, in fact, makes very little use of the commercial banking structure in Poland. They offer loans, savings, and other financial and non-financial services to Polish micro-enterprises. Applications are decided on the basis of factors such as motivation to repay; entrepreneurial skills; business viability; and cash-flow coverage. Loans are charged at commercial interest rates and guarantees from within the group structure are used to overcome the problem of lack of collateral. Clients only qualify for a second loan if their first is repaid on time.

In 1998, Fundusz Mikro reached operational break even.

Finally, there is a group of micro-lending institutions that specialise in offering **development loans** to established micro-businesses that are nearly bankable. Examples include Finnvera, in Finland, and the Aston Reinvestment Trust and ICOF, in the UK. Like those offering micro-credit these organisations generally aim for operational self-sufficiency. For example, in 1998, Finnvera micro-loans scheme covered 80 per cent of its operational costs from loan charges.

Micro-lending and commercial bank lending: the key differences

In the main, the distinct service delivery principles of micro-lenders, compared with commercial banks, are characterised in their small loan sizes; quick, easy access; and their non-commercial credit worthiness assessments and collateral requirements. The costs associated with this style of service delivery are covered by higher interest rates than are charged in the commercial sector, or via grant subsidies or both.

There are also a number of specific differences between micro-lending organisations and commercial banks, including:

- the institutional setting;
- loan products;
- marketing and client acquisition;
- risk assessment; and
- risk management.

These are explored in more detail below.

Institutional differences

Institutional differences are, perhaps, the most fundamental distinction between commercial banks and micro-lending organisations.

While commercial banks are formal financial institutions governed by a central bank act, micro-lending can occur in a variety of legal settings. Fundusz Mikro, for example, is a limited liability company; ACCION in the US grew from a voluntary organisation; Finnvera in Finland was founded by the state; and WWB in Spain is a private foundation. Some micro-lenders, such as Fundusz Mikro, ACCION, and ICOF (the Industrial Common Ownership Fund) and the Glasgow Regeneration Fund both in the UK, can issue loans from their own funds. Others, such as ADIE and WWB must work in partnership with formal banks as they are not legally permitted to issue their own loans.

The staffing of micro-lending organisations can also set them apart from formal financial institutions. While formal lenders' staff are generally professional bankers, micro-lenders tend not to recruit people with commercial banking backgrounds. In contrast, the majority of micro-lenders' staff come from non-banking backgrounds. Fundusz Mikro, in fact, considers a financial services background to be a disadvantage for its staff because they feel that their principle of credit delivery requires a very different mind-set to a commercial banking orientation. Ideally, they look for people with experience as entrepreneurs when recruiting loan officers. Many micro-lending institutions, such as ACCION, actually recruit staff that have more in common with the client group they are aiming to attract. Others, like ADIE and the Princes Business Trust, recruit existing or retired entrepreneurs, either as paid staff or volunteers, who can act as mentors for clients.

Because their clients are generally far less confident about making an application than customers of commercial banks, an important element of micro-lenders' marketing strategies involves offering active encouragement to potential applicants. Written, factual information is not enough to induce some potential clients to approach a micro-lending organisation. In addition, micro-lenders aim to minimise the transaction costs that clients face in making a loan application. They do not expect applicants to produce lengthy business plans, so the application process is quicker and easier than is the case with most commercial banks. Further, many micro-lenders visit the client's home or business premises to discuss the application, rather than expect the applicant to visit them, so that clients do not have to take time off work in order to pursue their application.

There are also differences between micro-lenders and commercial banks in terms of their decision-making structure. While many, although by no means all, commercial banks tend towards more centralised decision-making, often based on very hierarchical organisational structures, most micro-lending organisations have a much flatter hierarchy and decision-making is more decentralised. For example, ACCION New York's loan decisions are taken by an Internal Loan Committee, that meets each fortnight, and consists of the loan officers, the office manager, and the Chief Executive Officer of the New York programme. In Working Capital, however, decision-making is even further devolved. All loan applications to Working Capital are decided by the peer group, as apart of the group-lending model. The group members decide whether or not to support the application at all and, if the application is agreed, whether the full amount should be awarded.

In addition, many micro-lending organisations are distinct from commercial banks in terms of the non-financial support and assistance that is made available to clients. While most formal financial institutions maintain contact with successful loan applicants, to check their progress and pick up potential problems before they become too serious, they do not offer nearly as much practical help to clients as some micro-lenders aim to provide. People applying to micro-lenders for loans receive a great deal of support throughout the application procedure, particularly in organisations that tend to deal with socially excluded groups, to help them develop their business idea and produce the information necessary to support their request for assistance. This support continues after loans have been made to ensure that clients have the greatest chances of success.

This is, however, a controversial area among micro-lenders. Some, for example ACCION New York and Fundusz Mikro, do not, themselves, support clients. Most would agree, though, that support is needed by micro-entrepreneurs, even if they believe it is best provided by someone other than the lender.

Loan products

Micro-lenders are also distinct from commercial banks in terms of the loan products they offer. In Chapter 1 we outlined the ways in which bank lending can be inappropriate for micro-entrepreneurs. Micro-lenders have developed loan products specifically to address the needs of this group.

They offer smaller loans than are generally available from commercial banks. For example, Working Capital and ACCION both offer first loans of 500 Euros . Fundusz Mikro offers a minimum first loan of 1,600 Euros. And the Glasgow Regeneration Fund and Industrial Common Ownership Finance (ICOF) offer loans starting at 625 Euros, even though ICOF has calculated that it makes no profit on loans of less than 3,125 Euros. This enables micro-entrepreneurs to borrow enough money to get their business started without facing the problem of crippling repayment levels in the early years of trading.

They also offer shorter repayment terms than commercial banks. Micro-lenders such as Working Capital and Fundusz Mikro, for example, have repayment terms starting at three or four months. Others have minimum repayment periods of one or two years, but this is still shorter than would be available in the commercial banking sector.

In addition, they have developed new loan products, such as stepped loans, that are particularly suitable for micro-entrepreneurs. This means that people can begin by borrowing very small amounts of money repayable over a period of a few months, and then build up gradually to larger loans, provided previous loans have been re-paid on time.

Further, micro-lenders interest rates are not simply price reflective but are set to reflect the needs of their target group. Those organisations who offer social credit to socially excluded groups entering marginal self-employment tend to set their interest rates below bank base rates, so that this form of credit is cheaper than loans from commercial banks. Others, aiming at nearly bankable micro-enterprises seeking establishment credit, set their interest rates for first loans above basic bank rates. On the whole, though, interest rates are determined more by the philosophy of the micro-lender than by practical considerations. All the evidence suggests that their clients are less sensitive to interest rates than they are to the appropriateness of the loan product for their circumstances. Hence they are prepared to pay more for loans that are structured to meet their needs.

Finally, while commercial banks require collateral for their loans, micro-lenders can accept other forms of security. In Fundusz Mikro and Working Capital, for example, the group lending model means that each loan is guaranteed by the other members of the group. Other organisations, such as ACCION, require a co-signer for each loan who acts as a guarantor. Each of ADIE's clients have to provide the names of three to five people who guarantee 50 per cent of the loan and who can put pressure on the client in the case of default.

The loan products offered by micro-lending organisations are explored in greater detail in Chapter 4.

Marketing and client acquisition

Although most financial institutions have highly developed targeting and marketing strategies aimed at attracting new customers they generally do not actively promote their services on small enterprise lending. In addition, the advertising that does take place is closely linked to current account ownership, particularly in the UK, and promotional information tends to be sent out alongside account statements. People who do not have access to a current account will not receive this information. Consequently, in commercial banks it is generally clients that take the initiative in approaching the bank and the onus is on them to present their case and request the services and products they want.

The situation is very different in micro-lending organisations. Most micro-lenders operate active recruitment strategies, closely targeted towards their target market. These include:

- television, newspaper and radio advertising (ACCION New York);
- holding public information meetings, publicised through the media and leaflet and poster campaigns (Working Capital);
- using outreach workers to visit churches and community organisations (Working Capital)
- setting up a network of trade houses and holding an annual trade fair where existing clients can sell their products and micro-lending services can be advertised to potential borrowers (Women's World Banking, Spain);
- offering incentives to existing borrowers to encourage them to recruit new clients (Fundusz Mikro and ACCION New York).

The experiences that are relevant to a commercial bank wanting to adopt a more proactive approach to customer acquisition are discussed in Chapter 4.

Risk assessment

Methods of risk assessment are very different in micro-lending organisations compared with commercial banks. In general, commercial banks prefer to lend to businesses with existing track records or, at least, some relevant business experience that should reduce the likelihood of default on the loan. They are also usually looking for a clear and detailed business plan.

Applicants to some micro-lending organisations, such as the Glasgow Regeneration Fund, are also able to attend training courses to equip them with the skills they need to run a business. In addition, organisations such as the Princes Business Trust can make small grants to clients to enable them to carry out market research in advance of setting up their business.

Decision-making about loan applications to commercial banks is also constrained by the focus on business plans and financial records. It is very difficult for formal lenders, particularly those working within centralised decision-making structures, to take account of factors such as personal motivation or determination to succeed. Yet this is exactly what micro-lenders are able to do. Fundusz Mikro, for example, makes takes account of motivation to repay and entrepreneurial spirit in their assessment of credit-worthiness. ACCION requires applicants to show commitment to their business; be self-motivated; and show self-discipline and commitment towards ACCION. This enables them to make credit available to people who would be unable to obtain loans from a commercial bank.

Most micro-lenders also rely heavily on cash-flow statements to determine whether or not their applicants can afford the repayments on a loan they have requested. These aspects of risk assessment are covered in more detail in Chapter 4.

Risk management

Micro-lenders have also developed quite distinct procedures for risk-management that make them particularly effective at lending to micro-entrepreneurs. In essence, these procedures are based on providing incentives for borrowers to repay rather than instigating penalties for default.

For example, micro-lenders, such as Fundusz Mikro, Working Capital and ICOF, that issue loans for business development as well as start-up, include the repayment history on the first loan as a criterion in the risk assessment for subsequent loan applications. Stepped loans, in particular, are dependent on clients successfully repaying each loan before they can progress to borrowing larger amounts of money. In addition, organisations such as ICOF adjust the interest rates on further loans so that clients with a good repayment history will pay less for credit than those who present a higher level of risk.

Group-loans also provide a very strong incentive for borrowers to repay on time, because each member is responsible for the debt of the other group members. In Fundusz Mikro or Working Capital, borrowing groups are responsible for covering repayments that are missed by other group members. Further, nobody else in the group will be granted a further loan until the repayments of every member is up-to-date. This peer pressure is a very successful way of instilling a repayment discipline. Again, these aspects of risk management are further explored in Chapter 4.

Why should banks become involved with micro-lending?

Some commercial banks have raised a number of objections to becoming more involved with micro-lenders. First, they argue that there is already a mass market for micro-lending in Western Europe and that, consequently, the market is already well-served by banks.

Second, some believe that the capital gap for micro-entrepreneurs is illusory. They argue that people are not, generally, prevented from setting up a business by lack of capital and that factors such as education and experience are, in fact, more important. This argument is based on the belief that self-employment is not an appropriate option for many people.

There is also a belief among some bankers that micro-enterprises should not be the focus of too much concern as they are economically marginal and rarely create employment for others. Consequently, it is more effective to put resources into high-tech, high-growth businesses that will boost the economy.

However, interviews with a number of bankers who are involved with micro-lending organisations have identified a range of benefits. The advantages of involvement with micro-lenders fall into three main categories – social, political and commercial.

Social benefits

It seems that many relationships between micro-lenders and commercial banks are motivated, at least in the first instance, by philanthropic tendencies. It is not uncommon for banks to support voluntary organisations and charitable events. Micro-lending can be particularly attractive in this respect due to its potential to create jobs and contribute to area regeneration.

Offering support for micro-lending can, therefore, enable banks to demonstrate their sense of social responsibility and enhance their public image.

Political benefits

In the current political and economic climate, however, involvement with micro-lenders can also help banks build their licence to operate and avoid adverse regulation. This is especially the case in the United States, where banks must comply with the Community Reinvestment Act.

In the UK, there is a great deal of concern about groups of people who are unable to access financial services. The credit needs of micro-entrepreneurs have been a particular focus of these debates and were, in fact, the subject of a recent Policy Action Team appointed by the Treasury (Britain's Finance Ministry). Unless banks can demonstrate that they are making some effort to ensure that micro-entrepreneurs are not excluded from credit, they risk having legislation introduced to require them to lend in this market. This is unlikely to be the most efficient or effective outcome for either banks or micro-lenders.

In other European countries the situation is somewhat different. In Germany, strong savings banks and co-operative banks offer more micro-business lending and, consequently, political pressure for changes is not as strong. However, with commercial banks moving away from small business lending it is questionable whether savings and co-operative banks will be able to cope with all the demand for micro-credit.

Overall, the European Commission seems to be interested in the legal regulation of credit supply and has commissioned a feasibility study on the transfer of America's experience of the Community Reinvestment Act.

Commercial benefits

Interviews with bankers who are involved in working with micro-lenders suggest that the commercial benefits of doing so are much wider than might be expected. It is striking that several bankers, particularly in the UK where these relationships are most developed, recognised that there was a business case for involvement with micro-lenders.

In fact, several relationships that had started, initially, from philanthropic motivations had developed into more commercial relationships that were rewarding for both the bank and the micro-lending organisation. They recognised that commercial reward need not, necessarily, simply reflect the rate of financial return and that relationships do not have to be commercially rewarding to be commercially justifiable. They identified both direct and indirect commercial benefits.

Direct benefits

The most important direct commercial benefit to co-operation between banks and micro-lenders related to the potential for market-building. Some bankers recognised that micro-lenders can lend to some groups more effectively than commercial banks and that, consequently, they could learn from them and benefit from the partnership. This could mean developing methods of identifying the less risky micro-entrepreneurs among those currently rejected and developing procedures for lending to them directly. It could also involve issuing joint loans with micro-lenders, which enables banks to increase their profits without carrying the high risks of lending to this group.

Bankers were also aware that most successful micro-entrepreneurs will progress into mainstream banking and, at this point, present a relatively good business prospect. It can be instrumental, therefore, for banks to develop relationships with these clients early on in their business career to increase the chances of attracting them as customers. Referring micro-entrepreneurs to micro-lenders, rather than simply refusing their loan applications, could be an important element of this strategy.

Indirect benefits

Bankers also acknowledged that, in the current political and economic climate, social goals have a commercial value, even if it is hard to quantify.

One person who was interviewed for this research talked of the concept of 'corporate citizenship' – the belief that large organisations should be part of, and work to support, the communities they operate in and that, with increased competition, this could be an important element in survival. This is partly reflected in the fact that large non-government organisations, such as Oxfam, have begun to put their accounts out to tender on a regular basis. In deciding which bank should win their business these organisations take account of a bank's social and philanthropic activities. Consequently, supporting micro-lending activities could be a key element of a strategy to win, and keep, new business.

Summary

The term micro-lending is used to describe a range of different types of organisation, offering loans to a broad range of clients who could not, otherwise, obtain funding through commercial banking sources.

The obstacles facing micro-entrepreneurs in gaining access to appropriate finance mean that three main types of client tend to be seeking help from micro-lending organisations. These are:

- *socially excluded people,* entering marginal self-employment;
- people in or beyond the start-up phase with *micro-credit needs;*
- people running existing micro-enterprises in need of *development capital*.

The first group are generally in need of social credit, offered as part of a package of support and after-care that will enable them to cope with the process of applying for funds, setting up a business and managing a going concern. People with micro-credit needs generally have a good and well-developed idea or are already running a business, but are not bankable in commercial terms, either because they are considered too risky, or because the loan products available from commercial banks are inappropriate. Finally, people seeking establishment credit have needs that correspond much more closely to the products that are available in the mainstream market but their needs still cannot quite be met because they cannot convince a commercial bank that they are credit worthy.

There is no single model of micro-lending and organisations vary in terms of their scale and methods of working. A number of factors influence the style and structure of micro-lending organisations, including the social, economic and legislative context that they operate in and the type of clients that they aim to serve.

In the main, micro-lenders are distinct from commercial banks in terms of their small loan sizes, quick and easy access and their non-commercial credit worthiness assessments and collateral requirements. There are also a number of other specific differences, including:

- the institutional setting;
- loan products;
- marketing and client acquisition;
- risk assessment; and
- risk management.

Although commercial banks have raised a number of objections to becoming more involved with micro-lenders, interviews with bankers who are involved with micro-lending organisations have identified a range of social, political and commercial benefits.

Many banks already support micro-lending schemes and do so in a wide variety of ways, these are described in Chapter 3. Some banks with a long-standing involvement with micro-lending organisations recognise that there are important lessons that banks can learn from micro-lenders that would enable them to extend their own customer base. These are covered in Chapter 4.

3 Banks and micro-lenders: working together

Banks can develop three main types of relationship with micro-lenders. First, they can set up, and outsource all their micro-credit business to, a specialist branch or new company set up to deal specifically with this type of lending. Second, banks can co-operate with and support micro-lending organisations in a variety of ways. Third, commercial banks could learn from micro-lending techniques in order to develop their own lending in this high-risk market.

Both the motivation for banks becoming involved with micro-lenders, and the nature and extent of this involvement, will be determined by the aims of the micro-lending scheme and its client group. For example, outsourcing is likely to be the most appropriate relationship between a commercial bank and a micro-lender offering **social credit** to people entering marginal self-employment. It is unlikely that it would ever be economic for banks to lend directly to this group and it is, therefore, both more efficient and effective for them to pass this business on to a micro-lending organisation.

Outsourcing and the range of ways that commercial banks can co-operate with and support micro-lenders are described in this chapter, with some examples of how these relationships work in practice. The opportunities for banks to learn from micro-lending techniques are identified in Chapter 4.

Outsourcing

One strategic option for banks that decide it is uneconomic for them to try to offer social credit to people entering marginal self-employment is to create new companies, set up specifically to work with this target group. This can be an effective strategy where banks are under social or political pressure to respond to needs for credit that are incompatible with their ethos and working style. It can also be an extremely effective method of initiating a relationship with people that they cannot help at the moment but who could, in the future, become valuable clients.

There are a number of arguments in favour of this option:

- within the current process of restructuring towards more profit-orientated and streamlined relationship management it is difficult to implement new procedures or new products for a target group that is likely to be less commercially rewarding

- the margins in attracting the most desirable target groups, such as high potential medium size companies, are shrinking while the costs of acquiring new business in this area are growing;

- it offers an opportunity to meet needs via a more socially-orientated organisation that is separate from traditional, commercial procedures while still retaining the ability to control some of the risks of catering for this target group;

- such a specialist company can operate as a pilot project/pioneer to further knowledge and develop and test new lending techniques;

- it creates and supports a 'finance chain' that will bring successful clients to the bank in the future.

The most effective way for this type of organisation to work is described in the first handbook produced from this research project *Reducing Cost and Managing Risk in Lending to Micro Enterprises*[1]. However, from the bank's viewpoint, it is important that any new company that is created to meet micro-credit needs fits into the bank's own strategic framework. Consequently, it is important to take the following considerations into account:

- the type of micro-lending-activity that is most compatible with the corporate finance activities of the bank;
- the type of image that the bank wants to present in relation to micro-credit;
- whether micro-lending can facilitate the acquisition of attractive clients in the future;
- how much money should the bank invest in micro-lending activities, for example, do the future benefits make a long-term loss maker acceptable?

Outsourced micro-lending activities tend to develop in two main ways.

First, focussing on providing **social credit** to finance start-up activities among clients who tend to be most excluded from, financial services (see Chapter 2, Table 2.1). This would demonstrate a commitment to overcoming social and financial exclusion.

This requires the type of institutional setting and lending methodology that has been developed by organisations such as Working Capital, Boston; ADIE, France and the Prince's Business Trust, UK. However, it is important to recognise that working with this kind of target group can never be sustainable or cost efficient in the long term. The Bank of Ireland and First Steps are a good example of this form of outsourcing.

At the beginning of the 1990s the Bank of Ireland decided (under some political pressure) to invest in lending to small firms. First, a specialist "small firm department" was set up to support and lend to business start-ups and small firms. In spite of high-risk lending this department became profitable. Second, in respond to micro-credit needs, an intensive co-operation with a private sector initiative called First Step was set up in order to undertake social lending. The Bank of Ireland matches loan funds and took over some responsibility for supervision, by appointing and subsidising a bank manager to assess credit applications. The credit worthiness evaluation has taken on a different focus to that of the Bank of Ireland: more on personal strength, less on security and track records.

One representative explained that, while the bank recognised the demand for micro-credit *"we could not possibly support the applicants because their proposals failed to meet normal credit criteria and, secondly, a bank cannot lend interest free"*. Therefore it was decided to provide a special fund that could respond to this demand without having it within the bank's own loan portfolio. *"We effectively subcontract the business to a specialised organisation"*.

[1] Available from the Institut für Finanzdienstleistungen e.V., Burchardstrasse 22, D-20095 Hamburg, Germany. Tel. 0049 (0)40 309 691–10; Fax – 22; Email iff@iff-hamburg.de

Alternatively, if the bank's main goal is to develop their own lending provision in an area that has previously been perceived as uneconomic, outsourcing should target the entrepreneurs that are not bankable because they **have micro-credit needs** (see Table 2.1). Organisational examples of this type of micro-lending are ACCION in the U.S., Fundusz Micro in Poland or Finnvera in Finland. Outsourcing to this kind of micro-lending organisation may well reach profitability, particularly given that the founding bank will not have to meet the acquisition costs of taking over successful clients. The activities of one German high street bank provides a good example of this type of outsourcing.

A commercial German high street bank decided to restructure its small- and medium-sized corporate finance department to achieve more shareholder value. Part of this decision was to create a centralised department for start-up finance, based on business plan evaluation. However, this was perceived to be inappropriate for:

- micro business start-ups
- very young firms that are beyond start-up phase but still in the first three years of development with micro-credit needs.

Consequently, they are planning to set up a separate company in 2000 to cater specifically for this target group. This company is will have different loan products, a different kind of loan officer, and some support from public authorities. The bank provides the new company with zero percentage refinance capital, and on this basis cost coverage is planned in year 4.

This initiative gives the bank an opportunity, on one hand, to reduce the costs they face in dealing with this target group and, on the other, to demonstrate a strong social commitment. The main goal, however, is to identify potential high-worth customers in the micro enterprise market segment and transfer them to the parent company. A regional pilot will test whether there is a business case for a nation-wide expansion of this scheme in Germany.

Co-operation between banks and micro-lenders

Even among the eight micro-lending organisations that were benchmarked for this study there were a wide range of different forms of co-operation with commercial banks. Patterns of support and co-operation between banks and micro-lenders varied between the different types of organisation. So those offering **social credit** had developed very different relationships with banks to those working with micro-entrepreneurs with **micro-credit needs** or micro-enterprises or those in need of **establishment credit.** Working relationships between banks and micro-lenders were also influenced by the national context and, in particular, whether the micro-lender could issue loans themselves.

There were many examples of very constructive forms of co-operation which were beneficial to both banks and micro-lenders. Some of these relationships, particularly those between UK and US banks and micro-lenders, were quite dynamic, with banks already starting to re-define them as the partnerships developed. It is clear that working with micro-lenders need not be a one-way relationship and benefits were apparent for both sides. From the case studies carried out for this research it is possible to identify five broad ways in which banks have supported micro-lending schemes. They include:

- financial assistance;
- management and staffing;
- loan decision-making and administration;
- client support and practical assistance;
- client referral.

Financial assistance

Commercial banks can offer two main forms of financial assistance to micro-lending organisations – grants and loans. Further, loans to micro-lenders can be subsidised or issued at full market interest rates.

Grants

Grants to micro-lenders are generally made to organisations that offer social credit to people entering marginal self-employment. For example, the Glasgow Regeneration Fund received a total of £3 million in donations, including a five figure sum from the Royal Bank of Scotland. Similarly, Working Capital gets two thirds of its income from grants and many of the donors are commercial banks.

Grants are usually made via the social or Foundation arm of a bank. They are generally intended to improve the bank's public image and demonstrate a sense of social responsibility as well as to support the micro-lending organisation. Grants are mostly made to micro-lenders on a one-off basis although some banks make regular donations. Sometimes grants are linked to particular activities, such as supporting a specified clients group such as young people or ethnic minorities.

Barclays Bank, for example, gave a large grant to the Glasgow Regeneration Fund to set up a training course on Financial Management Skills for successful loan applicants. Developing these skills was central to the success of many of the entrepreneurs that were supported by the Fund. However, linking the grant to this particular course ensured that Barclays Bank could be confident that loan recipients who later became bank customers would be able to manage their business finances. This significantly reduces the risk of lending to them.

It is important to recognise, however, that micro-lenders offering social credit to the marginal self-employed are not aiming for sustainability and are, therefore, heavily and continually dependent on grants.

Loan capital

Banks generally make loans to the more commercially-oriented micro-lenders. Those dealing with micro-entrepreneurs with micro-credit needs generally receive loans at subsidised interest rates in recognition that the focus of their activities is still largely social. Consequently, they would be unable to sustain loans made at market level interest rates. Unsubsidised loans, made at full rates of interest, are generally only made to micro-lending organisations, such as ACCION, who are aiming for, at least, operational sustainability.

In the US, some banks support micro-lending organisations with a combination of loans and grants. Some banks offer loan capital at below-market rates; others issue loans at full market rates, but with a fixed subsidy/donation for each loan issued by the micro-lender. This is in recognition of the fact that the applications are more costly to process due to the additional support that applicants require. The proportion of subsidy per loan is usually 10 per cent (ie. $1 subsidy for every $10 loan) but it can be as high as 50 per cent. Making both grants and loans to micro-lenders enables banks to fulfil two sets of obligations imposed by the Community Reinvestment Act: they can demonstrate that they are both lending money in disadvantaged neighbourhoods and supporting grass roots organisations.

Management and staffing

Banks can support the management and staffing of micro-lending organisations by providing:

- members for the Board;
- seconded staff to work in micro-lending organisations;
- advice, training and consultancy.

Board membership

A number of the benchmarked organisations had board members provided by commercial banks. The Glasgow Regeneration Fund has a representative of the Royal Bank of Scotland to help with their strategic fund management. ADIE also has several banking representatives on its board. Micro-lenders offering social credit to the marginal self-employed were most likely to have commercial banks represented on their Boards because their business is a mixture of social work and lending. For this they require both social competence and a professional banking background – a combination of skills that is rarely found in one person. Consequently, the management boards of these organisations generally comprise a mix of both social and professional backgrounds.

Secondment of staff

Staff secondment from banks to micro-lending schemes is very common among British micro-lenders, but much less common elsewhere in Europe. For example, the Chief Executive of Aston Reinvestment Trust in the UK was originally seconded from Barclays Bank. Also, at the time of this research, Glasgow Regeneration Fund's Fund and After-care manager was seconded from the Bank of Scotland and the Fund Manager was seconded from the Clydesdale Bank.

Interviews with bankers indicate that, originally, banks perceived these secondments very much in terms of a 'donation' rather than a mutually beneficial relationship. Consequently, the staff that tended to be picked for secondment were mostly those who were moving out of the banking world, either due to redundancy or retirement. It was very rare for seconded staff to return to commercial banking once they had completed their secondment.

Recently, however, there has been an increased awareness of the benefits to banks of these secondments. They offer banking staff a chance to familiarise themselves with the micro-enterprise field and also provide important opportunity to learn how to lend successfully in this market. This has resulted in a noticeable change in attitude to secondments to micro-lending organisations in the UK. These programmes now involve higher level staff who return to the bank to share their expertise once their secondment is over. In fact, these secondments have become a key strategy in retaining high-flying staff in commercial banks.

This recognition of the mutual benefits of staff secondments to micro-lending organisations is illustrated by the fact that Glasgow Regeneration Fund are hoping to set up an on-going programme of annual secondments.

Staff training and advice and consultancy

Several commercial banks support micro-lenders by offering 'in kind' assistance in the form of staff training, advice or consultancy.

For example, the first loan officers appointed by Women's World Banking in Madrid were trained by one of Spain's largest savings banks, Caja Madrid. This bank was also WWB's first bank partner. This ensured that WWB's loan officers understood the way that commercial banks operated and the criteria on which they would assess loan applications. It also gave the loan officers a chance to experience the style of working in a commercial bank and the personalities of the people involved. Consequently, they could ensure that the support and guidance they gave to clients was appropriate for the bank's requirements. They could also prepare them for the way in which their meetings with the bank would be conducted.

From the bank's viewpoint, offering this training to WWB's loan officers meant that the loan applications they received were of a high quality and that the applicants were fully prepared for their interviews. As a result, the application procedure was less time intensive for them. Crucially, training the loan officers to apply the bank's criteria and priorities in assessing applications also meant that the referrals they received from WWB were the ones that were most acceptable to them. In other words, they had trained WWB staff to identify, on their behalf, the applicants who were most likely to be successful in running a business.

Banks also offer other forms of practical support to micro-lenders. They can provide office services, IT support, legal advice all of which would be very expensive for micro-lenders to develop in-house. In addition, this type of relationship gives micro-lenders access to higher quality services than they would be able to provide for themselves.

Loan decision-making and administration

Commercial banks can offer three main forms of support to micro-lenders in terms of loan decision-making and administration.

- membership of loan committees
- provision of banking facilities for micro-lenders
- provision of banking facilities for clients

Membership of loan committees

Both ADIE and the Glasgow Regeneration Fund have representatives from commercial banks on their loan committees. This is an extremely useful way of sharing expertise and helping micro-lenders to make judgements on their applicants' commitment and the viability of their business proposition. It isrelatively common among micro-lending organisations offering social credit to the marginal self-employed because they are, themselves, less business oriented and, therefore, less experienced in making these judgements for themselves.

However, it is important to recognise that experience of commercial banking is not always appropriate in relation to micro-lending and that bankers who sit on micro-lenders' loan committees often require a period of adjustment before they can apply their knowledge to this particular sector.

Providing banking facilities for micro-lending organisations

Some micro-lenders also rely on banks to provide them with the banking facilities that enable them to collect loan repayments from their clients. Micro-lenders are not usually formal banks and, therefore, lack the infrastructure that is present in other financial institutions. It is clearly more efficient and cost-effective if they utilise these functions on an agency basis with a commercial bank than to try to develop their own payment collection arrangements.

For example, all of ACCION New York's loan transactions are conducted through Chase Manhattan Bank. All loans are issued as cheques drawn on Chase Manhattan and ACCION staff will literally walk their clients to the nearest branch to cash their cheque if they do not have a bank account. In addition, all loan repayments have to be made at a set time and day at a named Chase Manhattan branch. Through its online banking facilities, ACCION can review the payments made at the end of each working day. Fundusz Mikro has a similar relationship with Kredyt Bank PBI, a commercial bank, that was selected on the basis of its extensive network and advanced electronic banking facilities.

Provision of banking facilities for clients

An extension of this type of relationship between commercial banks and micro-lenders involves making banking facilities available to the clients of micro-lending organisations. This is extremely important as many clients will not have access to banking facilities of their own, often for the same reasons that they are unable to obtain credit from a formal bank. This means that, unless the micro-lender is prepared to issue loans and receive repayments in cash, many potential clients would be excluded from using their service.

Micro-lenders, such as Fundusz Mikro and ACCION New York, who can lend directly to clients but cannot disburse or receive cash themselves, have both developed relationships of this sort with formal banks. As already noted, CHASE Manhattan Bank cashes loan cheques for ACCION New York's successful applicants. The same bank also receives the repayments from clients who do not have an account of their own. Similarly, all the transactions that occur between Fundusz Mikro and their clients are handled by their main bank partner Kredyt Bank PBI. ADIE also has an arrangement with a commercial bank who will open current accounts for their clients so that they can receive their loan and make repayments.

Practical support and assistance to clients

Commercial banks also have an extremely important role to play in offering practical support and assistance to micro-lenders' clients. This may take the form of a mentoring or advice service. Alternatively, banks can become involved in offering training to clients. This role is a crucial element of the after loan support that many micro-lenders make available to clients.

Banks generally play this role on a voluntary basis, perceiving it as giving something back to the community and, more importantly, helping to develop micro-enterprise. This type of relationship is particularly relevant for the micro-lenders offering social credit to the marginal self-employed. This is because their clients are likely to be least well-equipped to run a business of their own. Further, micro-lenders that pursue a social, rather than business, orientation may not have the necessary in-house skills to provide this type of support for clients.

This type of relationship between banks and micro-lenders can also be beneficial for banks, particularly those who are involved with organisations who lend to nearly bankable businesses. One UK banker referred to this as *'cultivating our future customer base'*.

Client referral

Customer referral can occur from formal banks to micro-lenders and, less widely recognised, in the opposite direction as well. It can, in fact, be a very valuable relationship for both parties.

Referral from banks to micro-lenders

Several bankers that were interviewed for this research said that, where appropriate, they would refer applicants who were not appropriate for bank finance to a relevant micro-lending organisation. Referrals in this direction, then, are a valuable source of client acquisition for some micro-lending organisations. This has two main benefits. First, it enables the applicant to obtain more appropriate funding and, potentially, become bankable. Second, suggesting an alternative route to inappropriate or unsuccessful applicants, rather than simply refusing their application, presents a better image of the bank to clients. This is particularly important if, in the future, banks want to attract these clients once they have become bankable. Experience of referrals from banks to micro-lenders, however, is mixed.

ACCION found people who were referred to them by mainstream banks were often problematic clients. This does not suggest that referrals in this direction cannot be productive. It does indicate the necessity of a close working relationship between the bank and the micro-lender to ensure that referrals are appropriate.

Referral from micro-lenders to banks

In addition, however, there is potential for micro-lenders to pass clients on to banks and, consequently, to generate new business for them. This type of referral can take a number of forms and involve varying degrees of partnership.

First, if a micro-lending organisation is approached by a client who is bankable but, perhaps unfamiliar with the formal financial services sector, they can advise them to apply for bank finance and simply offer support with the application process. This is the kind of relationship that Women's Work Banking in Spain has with their bank partners.

Second, a central aim of micro-lending is that, by getting and repaying a loan, entrepreneurs can become bankable with mainstream financial institutions. Former clients of micro-lending organisations are attractive to banks for a number of reasons. They have survived their early years of trading, the period at which they are most at risk of failure. In addition, they will have acquired many of the practical skills they need to run a business from the training and practical support that micro-lenders make available to their clients. Finally, having successfully repaid a loan, they have established a credit history and, therefore, present a much better risk to the bank than they would previously have been.

Working Capital has an arrangement with the Bank Boston whereby they look favourably on applications from clients of this micro-lender, although they still have to undergo a credit check. They also have an arrangement with the Cambridge Savings Bank, whereby they provide $ for $ matched loans.

Third, micro-lenders who cannot lend directly to clients refer all their applicants to formal banks but, crucially, act as a guarantor so that the bank is not bearing all the risk of making the loan. They also usually provide extensive client support as well as assistance in making the loan application to the bank. In such cases, the micro-lender therefore bears all the cost of the credit worthiness assessment and any after-care or support that the client requires.

Women's World Banking in Spain, for example, refers clients to five banks with whom they have developed partnerships. About 95 per cent of these loan referrals are accepted by banks.

Similarly, 75 per cent of ADIE's clients receive their loans from a formal bank, with ADIE providing a 70% guarantee. Only one loan is provided in this way and ADIE's bank partners are willing to lend to a very high proportion of ADIE's ex-clients.

Fourth, some micro-lenders, particularly those dealing with nearly bankable micro-enterprises, have a more direct relationship with formal banks. In these circumstances, the micro-lender can make a part-loan and ask a bank to provide 'top-up' finance. This arrangement can be very beneficial for the bank, because they are not being asked to lend more than is commercially viable for them. In addition, they know the client will receive practical support and after-care from the micro-lender, which will reduce the risk of default. This type of referral is very common in organisations like Finnvera and the Aston Reinvestment Trust.

Finally, some micro-lending organisations have developed even more direct working relationships with banks who will enter into joint funding arrangements with them. For example, Working Capital has an arrangement with the Cambridge Savings Banks who will match loans, $ for $, without a credit check. Aston Reinvestment Trust has also set up a number of joint financing arrangements with formal banks.

Summary

Banks can develop three types of relationship with micro-lenders. First, they can set up, and outsource all their micro-lending business, to a specialist organisation designed specifically for this purpose. Second, they can co-operate with and support micro-lending organisation in a variety of ways. Third, commercial banks can learn from micro-lending techniques in order to develop their own lending in this high risk market. Both the motivation for banks becoming involved with micro-lenders, and the nature and extent of this involvement will be determined by the aims of the micro-lending scheme and its client group.

One strategic option for banks that decide it is uneconomic for them to try to offer social credit to people entering marginal self-employment is to create new companies, set up specifically to work with this target group. This can be an effective strategy where banks are under social or political pressure to respond to needs for credit that are incompatible with their ethos and working style. It can also be an extremely effective method of initiating a relationship with people that they cannot help at the moment but who could, in the future, become valuable clients.

Outsourced micro-lending activities tend to develop in two main ways. First, focussing on providing social credit to finance start-up activities among clients who tend to be most disadvantaged in relation to, or completely excluded from, financial services. Second, if the bank's main goal is to develop their own lending provision in an area that has previously been perceived as uneconomic, outsourcing should target the entrepreneurs that are not bankable because they have micro-credit needs.

There were many examples of very constructive forms of co-operation between banks and the benchmarked micro-lenders and it is clear that working with micro-lenders need not be a one-way relationship. There are five broad ways that banks have supported micro-lending schemes:

- financial assistance;
- management and staffing;
- loan decision-making and administration;
- client support and practical assistance; and
- client referral.

The striking thing about talking to bankers about their relationships with micro-lending organisations is how positive they are about these arrangements.

While they may have begun co-operating with micro-lenders out of philanthropic intentions they have, at least in the UK and the US, begun to recognise the benefits that banks can reap from doing so. Not only can micro-lenders and banks develop very constructive, mutually beneficial relationships but their clients can become very profitable customers for mainstream banks.

A representative of Barclays Bank noted that as their relationship with micro-lenders developed, it was less and less about donating money and increasingly about forging a mutually beneficial partnership.

The advice of a representative of the Cambridge Savings Bank, which works closely with Working Capital, to other banks who may be thinking of getting involved with micro-lending was, *'It's worth the risk. it is profitable for the bank because these people are coming back'*.

4 LEARNING FROM MICRO-LENDERS

In lending capital to specific segments of the SME market, such as start-ups, micro-businesses and high-tech companies, banks are often confronted with unacceptably high credit risks and low margins on the business.
(Third Round Table of Bankers and SMEs Final Report, 2000)

As the report of the third European Round Table of Bankers and Small and Medium Size Enterprises notes, two main factors tend to restrain bank lending to micro-entrepreneurs: the high risk of default and the low margins on lending in this market. While few micro-lenders have reached financial sustainability, a number aim to cover at least their operational costs and most have taken steps to reduce costs and risk. Some of these are akin to traditional small business lending by commercial banks. Others are remarkably similar to techniques deployed by reputable commercial companies that lend in the high-risk end of the personal credit market.

Of course, not every bank wants to lend in this high-risk market. Others have recognised that, even if they do so, such lending will not always be profitable or cost-effective in the short term, and will only provide a return in the medium- to long-term. It is, therefore, worth exploring the techniques used by specialist micro-lenders to see which, if any of them, might be deployed or adapted for use within the formal banking sector.

In Chapter 2 we outlined some of the broad differences between commercial bank lending and micro-lenders. In this one we concentrate on some of the key issues identified in the course of the research that may be applicable in a commercial bank setting. These relate to the development of appropriate loan products; marketing and customer acquisition: pre-credit risk assessment and post-credit risk management and dealing with default. Each of these is discussed critically covering both what seems to work and what does not.

Successful loan products

In all cases, the micro-lenders we benchmarked have attempted to develop loan products that are tailored to the needs of their clients. And, as might be expected, these vary according to the main target group of the micro-lender: those most appropriate for the marginally self-employed are not necessarily so for established but risky businesses looking for working capital. They also vary with the legislative constraints on small business lending. As discussed in Chapter 2, in some countries, such as the United Kingdom, non-banks are permitted to make loans (but not to accept deposits) and here we find micro-lenders that raise loan capital and offer direct loans to their clients. In other countries, such as Spain, this method of working is not permitted. Moreover, even in countries where direct micro-lending is permitted, usury laws may influence the working practices of micro-lenders.

As a consequence, a wide range of different loan products has been developed for the micro-lending market. There are, however, some elements that are common to a number of micro-lenders even if they are not combined in exactly the same way.

Stepped loans

One of the most widely used, among those able to make direct loans to micro-entrepreneurs, is the stepped loan. Borrowers are, in effect, assessed for a credit line, which is delivered in a series of discrete loans, beginning with small amounts lent for a short period and then increasing in size and length depending on the customer's repayment history. In such cases, a typical first loan would be around 1,000 Euro, and would be repayable in less than a year, although this clearly varies with the type of micro-entrepreneur.

For example, at Working Capital which lends to the marginally self-employed and new business start-ups, the steps are:

- $500 (500 Euros) repayable over 4-6 months;
- $1,000 repayable over 4-12 months;
- $2,000 repayable over 4-18 months;
- $4,000 repayable over 4-24 months;
- $6,000 repayable over 4-36 months;
- $10,000 repayable over 4-36 months.

Almost all micro-lenders that offer their customers more than one loan use stepped loans. So, too, do reputable commercial credit companies that specialise in personal loans to people on low incomes. Moreover, it is clear that this is also the preferred method of borrowing among people on low incomes, whether for personal or business use as it gives them more control. Not only are the repayments are lower, but the shorter loan period means that they can reassess their situation before committing themselves to further borrowing.

Stepped loans have a number of advantages both for the borrower and the lender. First, they enable micro-entrepreneurs to build-up a credit history without putting the micro-lender at risk of incurring large amounts of bad debt. Second, they allow people who are not used to running a business to develop gradually without the risk of running-up unmanageable credit commitments. From a bank's point of view, the size of the loan increases with the information they have about the borrower. Third, stepped loans grow with the business. This is in contrast to most business finance packages, where there is over-liquidity at the beginning and a liquidity shortage when the business begins to take on bigger contracts. Fourth, stepped loans are much easier for micro-lenders to administer because they can be offered as a standard package and necessitate less individual packaging.

The stepped loan has clear advantages in terms of risk reduction but, equally clearly, short-term margins are likely to be very low, especially where the first loan is very small. But, as noted above, experience has shown that in the long-run it can lead to a profitable customer.

Fixed repayments

Fixed repayments are a key element of loans from a micro-lenders. It is extremely important to people with limited resources that they know exactly how much their repayments will be and when they need to be made. This gives them the control they need to budget effectively.

In addition, a small number of micro-lenders take this a stage further and charge no penalties if payments are made late or missed altogether. Tin these cases, the costs of anticipated default are included in the loan charges from the outset. This is controversial even in the micro-lending movement and is by no means a universal practice. It is, however, important to note that the micro-lenders who provide fixed payment loans – Fundusz Mikro and ACCION, for example – are also the ones that are most sustainable financially and have low levels of default.

Again, this is a practice that is widely used among commercial credit companies that lend in high-risk personal loan markets. It is also one that many customers find acceptable, because it gives them more control over their finances. This is especially so for the marginally self employed and new micro-entrepreneurs. What they fear more than anything is unexpected and unbudgeted expenditure. From the lender's perspective, it can reduce the risk of serious default – but only if accompanied by a firm but fair arrears recovery procedure (see below).

Interest rates

One of the key lessons from micro-lending is that for some micro-entrepreneurs' access to appropriate credit is more important than cost. In general, the interest rates charged by micro-lenders lie somewhere between banks' rates and those charged by commercial lenders that specialise in high-risk personal markets. Where there are usury laws, micro-lenders' rates are often at or just below the ceiling. As described in Chapter 2, some micro-lenders set their interest rates to reflect the higher costs and risks associated with lending to micro-entrepreneurs. Charging at this level also helps them to work towards operational sustainability, which is not possible in organisations that charge lower interest rates than traditional banks.

Interest rates are likely to be as controversial for banks, as they are within the micro-lending movement. Small business lobby groups that campaign against price discrimination by banks have raised two key objections. First, that it is unfair to charge more for the same service and that cross-subsidies should cover variations in risk. Secondly, that charging higher risk customers more will reduce their likelihood of survival.

Interviews with clients of micro-lending organisations indicate that the higher interest rates do not necessarily present a disincentive to borrowing. On the contrary, customers are prepared to pay higher charges – but only for more appropriate loan products that are designed specifically to meet their needs. What they object to is being charged more than other customers for standard products that do not really match their needs.

Further, loan default rates and business failure rates are no higher among customers of micro-lenders charging high interest rates than they are among those borrowing from soft (subsidised) loan schemes.

Appropriate security

Micro-lenders do not accept property or other forms of traditional security for the loans they make. Indeed, many banks would agree that such security is inappropriate for this market.

Some micro-lenders, for example ACCION New York, take personal goods, such as stereo systems, videos etc, as security. Loans to taxi drivers are often secured upon their car. But ACCION admit that this is mostly symbolic and used to impress upon their clients that they should take loan repayments seriously. They seldom take possession of these goods. On the other hand, other micro-lenders, such as Fundusz Mikro, believe that collateral can reduce a borrower's commitment to repay their loan if times get difficult. While in Finnvera it is believed that loan security can distract the lender from the need to assess fully the customer's ability to repay.

Loan guarantees are used more widely by micro-lenders than other forms of security, but even these are controversial. Experience has shown that in the high-risk micro-lending market, guarantors (or co-signers as they are sometimes known) should be other entrepreneurs and not friends or family, who seldom understand what they are signing. And the amounts of money guaranteed should be small and ones the co-signers can realistically afford to pay. The main advantage of guarantees is in filtering out the riskiest loan applications at the outset rather than recovering sums of money outstanding once a 'bad' loan has been made.

Group lending and repayment collection

To many people group lending is virtually synonymous with micro-lending. In the developed world this is not the case, and there are many micro-lenders who only make individual loans. Moreover, group lending takes many different forms. In Working Capital, which draws upon experiences of the Grameen Bank, group members provide one another with practical support, vet one another's loans, act as a means of collection of loan repayments as well as guaranteeing one another's loans. In contrast, Fundusz Mikro's groups are primarily designed for loan guarantees. In this section we concentrate on these two aspects – customer support is covered below.

Borrowers from Working Capital have a group 'buffer fund' into which they pay 10 per cent of all loans they are granted. Group members meet monthly to collect together their loan repayments, which the group Treasurer then forwards to Working Capital. If any member is unable to make their repayment, the group can decide to draw upon the buffer fund to make up the shortfall until the defaulting member can afford to pay.

Fundusz Mikro groups, however, operate slightly differently and are, essentially, a mutual guarantee scheme. In fact encouragement to form groups is built into the design of Fundusz Mikro's price and loan guarantee structure. Individuals may apply for a loan, but must supply up to three guarantors and pay a higher interest rate. Both the number of guarantors and the loan interest rate fall the more people who form themselves into a group. So that groups of four or more people require no guarantors at all and pay the lowest interest rates.

Number of borrowers	Number of guarantors	Annual interest rate
1	At least 3	37%
2	At least 2	35%
3	At least 1	33%
4-7	None required	29%

The incentive structure has been set so that, in practice, 80 per cent of loans are made to people in groups of four or more. Groups elect a Treasurer who collects and forwards repayments to Fundusz Mikro.

The advantages of these two approaches are three-fold. They reduce the cost of payment collection. They reduce the risk of default through peer group pressure. And, linked to this, they provide guarantors who are aware of the implications of the security they are supplying.

Customer support

Few people would disagree that the micro-lending market is typified by a need for customer support as well as loans. But there are big differences in the type and level of support needed by different types of customer and in how that support is provided.

Marginal self-employment

People entering marginal self-employment often need intensive support and mentoring, both before applying for a loan and after. Most need practical assistance with the financial side of their business – developing financial plans and monitoring cash flows. In addition, some need moral support and encouragement; some require help with marketing and business planning; and some need technical assistance. Micro-lenders operating in this market tend to provide this support in-house.

ADIE and the Prince's Trust provide this support through a team of volunteer mentors who work alongside the micro-entrepreneur. For the most part, these mentors are people with relevant experience in banking or business. In addition, ADIE has developed specific training sessions, including three games:

- *Cash-flow* focuses on cash handling and constructing a budget.
- *General Management* covers more ordinary elements of running a business, such as customer service.
- *Stocks and Inventories* is a further development of small-scale accounting practice.

Working Capital, on the other hand, provides this support mainly through their groups and does so in a number of different ways. Group members provide mutual support and exchange practical assistance. Monthly meetings of new groups act as the focus for working through a practical handbook, covering among other things how to produce cash flow statements and business plans. At every stage this handbook encourages entrepreneurs to assess the strengths and weaknesses of their businesses and how best to develop them. Working Capital also organises special training events at which selected members pass on their positive and negative experiences to others. They also have a telephone support service staffed by their more successful members who contact people who have joined Working Capital, but are inactive, to see if they require any practical assistance.

New and existing micro-entrepreneurs

The needs of new and existing entrepreneurs range from specific advice and training to detailed consultancy. And these needs are usually met by someone other than the organisation that provides loans. Indeed, it has been argued by some micro-lenders that combining both functions within a single organisation can adversely affect the lending portfolio as they have rather different aims.

Some micro-lenders, such as Women's World Banking in Spain, concentrate entirely on providing advice and support alongside loan guarantees, as they are prohibited from making loans by Spanish Banking law. All their clients are referred to banks, who actually make the loan.

Others, such as ACCION New York and Fundusz Mikro concentrate on providing loans to their customers, but refer them to specialist sources of advice and support as needed. Similarly those, like Finnvera and ART, that specialise in development loans, will help their clients obtain specialist help and consultancy if required.

Attracting the right clients

Just about all micro-lenders aim for active, targeted acquisition to attract people who are on the margins of banking, but are not a very high risk. But the main lessons here are negative rather than positive ones.

Experience with advertising through the mass media has identified substantial drawbacks. On the whole this method of promotion attracts large numbers of people who are subsequently found to be unsuitable for a loan. ACCION New York, for example, has found that only nine loans are granted for every hundred people who contact them.

Use of referral agents has resulted in mixed success, depending on the source of referral. On the one hand, social agencies have often been found to refer people who are subsequently screened out as being inappropriate for a loan. While small business organisations tend to screen out too many people to whom a loan could have been made. The best sources of referral are generally the enterprise agencies that exist to support business start-ups and new businesses wanting to develop. Both Finnvera and Aston Reinvestment Trust have had positive experiences with such referrals.

In general, though the most successful means of customer acquisition is through other entrepreneurs. Indeed, the report of the third Round Table of Bankers and SMEs also draws attention to this.

A number of micro-lenders have taken steps to encourage existing clients to recommend others. As already discussed, Fundusz Mikro has a pricing structure that encourages would-be borrowers to look for others to form a group. By doing so, they qualify for a lower interest rate on their loan and do not need to provide guarantors. Experience has shown that because group members offer one another a mutual guarantee scheme, they are very cautious in selecting one another.

ACCION has chosen a more direct way of offering incentives to a carefully selected group of existing customers, offering them a $50 payment for each referral they make that results in a loan. Because borrowers often have no other source of credit open to them they, too, are cautious about the people they refer.

It is interesting to note that commercial credit companies operating in very high risk personal lending markets have similar experiences to ACCION, although most do not offer a cash incentive for referrals. Licensed moneylenders in the UK, for example, seldom advertise to attract new customers, as they have found personal referrals from existing customers have a much higher acceptance rate and a much lower risk of defaulting on loans.

New forms of risk assessment

Like any other lender, micro-lenders do not lend to everyone who approaches them. As a consequence, they have developed criteria and techniques for identifying 'good' risks from 'bad' in what is fundamentally a high-risk market.

Criteria of risk assessment

The risk assessment criteria micro-lenders use depend on the types of customers they have, and range from an emphasis on commitment and personal factors where the main client group is the marginally self-employed, to greater use of business plans if clients are established businesses that are nearly 'bankable'.

Commonly, micro-lenders assess the character of the person making the loan application. Fundusz Mikro, for example uses manuals of psychological assessment to ascertain the level of motivation of a micro-entrepreneur to make their business succeed. ACCION New York assesses the degree of support of an applicant's business by their husband or wife. They also ask for personal references.

Micro-lenders also assess business strength, but with much less emphasis on a business plan than would be the case in a bank. Indeed, many micro-lenders have learnt to their cost that micro-entrepreneurs that provide a near perfect business plan have often played little or no part in drawing it up.

On the whole, they look for relevant start-up experience, even if it is in the informal economy. Bobby, who was described in Chapter 2 is a good example. He had considerable experience of making leather bags, even though he had never attempted to earn a living from it. In contrast, people with merely a business idea, have been found to be a much higher risk.

In addition, most micro-lenders look for evidence of a positive cash flow (in both the recent past and the immediate future) that is sufficient to meet loan repayments. In making these assessments they deploy a high degree of cultural sensitivity, recognising that among some ethnic groups it is usual for all members of the family to work in a business and to expect little more than a basic but stable income from it. Fundusz Mikro goes one step further and bases its loan decisions on a double cash flow assessment – one made by the customer and the other by the loan officer.

Finally like banks, most micro-lenders rely on past payment records. One of the main differences is that they often make more extensive checks of personal bill-payment. ACCION, for example, asks loan applicants to provide recent bills and statements from utility companies and obtains references from landlords where appropriate. The other main difference, is the use of stepped loans, as described above.

Methods of risk assessment

In many cases the micro-lender's loan officer visits the home and/or business premises of the loan applicant.

For example, Fundusz Mikro loan officers visit the applicant to determine the applicants degree of commitment to their business, to undertake the cash low assessment and also to discuss whether or not a loan is the best way of tackling the issue identified. So if it is discovered during the visit that a loan application is primarily needed to cope with a temporary cash flow problem it may be refused or, more likely, a loan given to implement a better system of cash-flow management. While there is little doubt that this is the ideal method of making the risk assessment, it is costly. At the same time, Fundusz Mikro has achieved operational break-even, despite its reliance on loan officer visits.

Working Capital, in contrast, places much greater emphasis on peer review and self-assessment – partly to reduce costs and partly for ideological reasons. All loan applications are determined by the loan group, who question the applicant, drawing on guidelines contained in the borrowers' handbook. This encourages the group to question firstly, whether a loan is the appropriate way of tackling the issue identified by the applicant and secondly, how the loan would be repaid should the business income be inadequate to meet repayments. In practice, however, this approach seems to be far more successful with people entering marginal self-employment and micro-business start-ups than it is for more established micro-entrepreneurs wanting working capital. In the latter case, the commitment to working as a group is much weaker. It is also most appropriate where entrepreneurs are at a similar stage of development, as inexperienced people are unable to assess the loan applications of those with more developed businesses.

Two of the micro-lenders that were benchmarked – ACCION New York and Fundusz Mikro – had developed interesting methods of risk assessment that could have particular relevance for banks. For this reason they are described in more detail.

ACCION New York

Credit assessment in ACCION is based on three main considerations: the applicant's need for a loan, the repayment potential, and the character of the applicant, including their entrepreneurial motivation.

It begins with an orientation meeting during which loan officers explain what ACCION can and, more importantly, cannot support with a loan, how to apply for a loan and how loan decisions are reached, and subsequent credit management techniques. The applicant then completes an application form that collects the following information:

- **Personal information:** net household income, household circumstances
- **Business information:** location, type of business, number of paid workers, credit history of the business, business assets, business liabilities.
- **Loan request information:** size of loan, purpose of loan.

In addition, applicants are required to provide the following supporting information:

- At least two of the following bills: telephone, cable, credit card, gas, electricity
- Original copy of home or business lease, as appropriate
- Current monthly bank statement
- Co-signer's information sheet, plus their most recent four pay slips.

The loan officer discusses the financial analysis of the business with the applicant before taking up references and asking for proof of identification (for example, driving licence, identification card, passport, Resident Alien Card, Social Security Card). It is then that a site visit is made to the applicant's home or business premises. The loan officer then makes a report to the loan committee, which makes the final decision.

Interestingly, ACCION has recently commissioned a company to build a credit score card based on their loan portfolio. This will be used to identify from loan application forms the 10 per cent of cases that should be refused outright and the 10 per cent that should automatically be granted a loan. The remaining 80 per cent of applications will be assessed manually, using the techniques described above that have been refined with experience. At the time of writing this work had not been completed but could, potentially be very useful for any bank wanting to extend its lending to micro-entrepreneurs.

Fundusz Mikro

The credit risk assessment procedure in Fundusz Mikro also begins with the loan offer explaining to would be applicants key aspects of taking out a loan. This includes: the two types of loan (individual and group) that can be made and factors to bear in mind when selecting fellow-group members; how decisions on loans are made and the procedures for loan repayment and handling default.

If appropriate, this is followed by a meeting with group members to discuss mutual obligations, to assess the personal links between group members and to assess the business links between them. All applicants are also met individually to assess their motivation and business skills and, if relevant, re-examine the links between group members.

The loan officer then visits the applicant, following which he/she completes a two page risk assessment form. If necessary the Fundusz Mikro branch manager also visits to make a second assessment. The final decision is then made by the loan officer and their branch manager or regional manager (or Headquarters Credit Operations Director for loans of more than Z 20,000 or just under 7,000 Euros), whose main role is to ensure that the risk has been correctly evaluated.

The Fundusz Mikro loan risk analysis form comprises twelve key questions , that must be completed by the loan officer following visits to the loan applicant and, if appropriate, to a meeting of their loan group.

1. Why will the borrower want to repay the loan?
2. How did you form your opinion?
3. Which features of the borrower demonstrate that he/she will know how to use and repay the loan?
4. What caused you to form this opinion?
5. Which features of the business indicate that it will be able to repay this and futurre loans?
6. What caused you to form this opinion?
7. What were the assumptions of the cash flow prognosis?
8. Why do you consider that this is probable?
9. What is the main risk factor connected with
   – motivation to repay,
   – borrower's entrepreneurship,
   – the business
   – cash flow
10. What actions has the borrower undertaken to minimise these risks?
11. What actions have you undertaken to minimise the risk of the loan?
12. Whay do you consider the actions you have taken are sufficient to recommend the loan?

The four criteria used by Fundusz Mikro in making the assessment of credit worthiness are:

- motivation to pay;
- entrepreneurship and entrepreneurial skills;
- business viability;
- cash-flow position.

Of particular interest is the shift in importance of these criteria, with the size of the loan and the number of previous loans that have been received. This is shown in the table below.

	Weighting factor			
	Z5,000 loan	Z10,000 loan	Z15,000 loan	Z30,000 loan
Motivation to pay	40	35	28	10
Entrepreneurial skills	30	28	26	20
Business viability	20	22	24	30
Cash flow position	10	15	22	40

So, for a small first loan of, say Z5,000 (1,600 Euros) greater emphasis is given to motivation to pay, followed by entrepreneurship. In contrast, a loan of Z30,000 (just under 10,000 Euros) much more emphasis is placed on the cash flow position and business viability.

In addition, loans are only granted to an individual if each their four guarantors has a regular income that is sufficient to meet the loan repayments should the borrower default. While, group loans are also judged according to the reliability of the group network. This includes an assessment of: personal links between group members; their trade links; risk concentration within the group and the relative growth prospects of group members.

There are three other important aspects of pre-credit risk assessment. First, all loans are smaller than 200 per cent of the existing assets of the enterprise. Secondly, all borrowers must sign a blank bill of exchange /'wechsel', which simplifies court proceeding to recover bad debts but, more importantly, has a strong psychological effect on borrowers commitment to repay. Thirdly, as in ACCION, there is a strong emphasis on making all procedures transparent to borrowers, including those for both risk assessment and for debt recovery.

Managing the risk of default

Post-credit risk management is, arguably, even more important when lending in a high-risk market than would normally be the case. Once again, micro-lending organisations have developed techniques that are appropriate to the clientele they serve. These can be grouped into three broad themes: active loan after-care; reliance on incentives to pay, rather than penalties for default; and very firm but fair management of default.

By using these techniques in various combinations, and just as importantly, making them transparent even before a loan is granted, they are usually able to contain default (defined as one missed payment) to under 10 per cent.

Active loan after-care

While most micro-lenders offer some form of loan after-care, the nature of that care depends on the type of customer they have. As already noted, most of those offering loans to people in marginal self-employment provide detailed support and mentoring in most aspects of running their business. The aim of this assistance is to increase the survival rate of these high-risk micro-enterprises.

In contrast, micro-lenders that offer loans to new and existing micro-entrepreneurs are often more concerned to encourage and assist their customers to plan for future growth. In these cases, direct involvement by the micro-lending organisation is often restricted to half-yearly visits – and visits when a further loan is required. But they will also arrange independent expert advice or consultancy and may make this a condition of granting the loan. This was, for example, the case with the locks and security systems company described in Chapter 2.

Payment incentives

Most micro-lenders have discovered, through experience, that incentives for prompt payment are both more appropriate and, more importantly, more effective than penalties for late payment. These incentives take a number of forms.

In most cases, customers can obtain a further loan immediately and without detailed assessment if all repayments on a recently closed loan were made in full and on time. Some micro-lenders go further and offer a lower interest rate on the loan if all the previous repayments were made in full and on time. Fundusz Mikro, for example, found that the level of default fell when they replaced penalty charges with these two incentives. They have identified two reasons for this. First, penalties encouraged some borrowers to believe it was acceptable to occasionally make late payments, as they would be paying extra for this 'privilege'.

Secondly, they found that the penalties were having an adverse effect on borrowers with temporary cash flow problems making it even more difficult to pay. Once again, this is an approach that is also used by commercial lenders that operate in the high-risk personal credit market serving low-income households.

In addition, the micro-lenders that operate through lending groups, use peer pressure to ensure prompt payment. This is achieved by placing responsibility for loan repayments on the group as a whole, so that a single payment is made to the micro-lender regardless of the number of members with a loan. Under-pinning this are policies of not granting further loans to any group member if one of them is behind with their payments.

Firm but fair debt management

While most lenders will aspire to a firm, but fair debt management procedure, micro-lenders are often much firmer than many commercial creditors would feel was possible. It must be acknowledged, however, that they have arrived at these procedures through adverse experience. Many micro-lenders have, in the past, experienced very high levels of default and tightened their debt management as a consequence. Independently, a number of micro-lenders have arrived at broadly similar conclusions about how best to ensure prompt payment.

First, they have a fixed time and place for each repayment. Secondly, they have on-line bank accounts, which enable them to check whether or not a payment was made at the agreed time and place. Thirdly, they have a 'one-day late' policy – in other words, they contact borrowers who fail to make their repayment at the time agreed within 24 hours to discuss the reason why payment was not made. In cases of genuine difficulty they will use forbearance and reschedule the loan if this seems appropriate. Otherwise pressure to pay is exerted on the borrower immediately and any guarantors are also contacted. Thereafter the arrears recovery procedure escalates fairly quickly – or at least it appears to from the borrower's point of view. An impression is created of the matter being passed through to more senior colleagues even when, in reality, it is at first dealt with by a second loan officer. As a last resort, most micro-lenders are now prepared to take cases of deliberate non-payment to court or to hand the loan over to a debt collection form. In practice, these actions are very rarely needed.

Yet again, these approaches are also the ones used by commercial companies who lend to high-risk, low-income households. Their experience has also shown that it is important to impose a routine that gives the lender control over the time and place for repayments to be made. They also use forbearance, indeed, such companies in the UK find that, on average, a 26 week loan is repaid over a period of 30 weeks. They impose no extra penalties for this – because most of their borrowers will need to miss the occasional payment, they include the costs in the original terms of the loan. Equally, though, they make it clear to their borrowers that, while they are prepared to be understanding in cases of genuine hardship, in other circumstances they will pursue payment rigorously. In this way they can keep default and court proceedings to a minimum, avoid the high costs of debt recovery and retain borrowers.

Default rates and operational sustainability of micro-lenders

By deploying these techniques the micro-lenders studied generally had default rates that were under 10 per cent. At the same time those studied that specialised in micro-credit or development credit had also been able to achieve between 40 and 115.6 per cent operational sustainability, as the table below shows.

It proved to be impossible, within the present study, to collect more detailed statistics that could be presented in a comparable way. Further figures are, however, given for individual organisations in Appendix 1.

In addition, the MicroFinance Network publishes detailed performance indicator statistics for its members, which are the larger longer-established micro-lenders that operate mainly in developing countries, but include Fundusz Mikro. These statistics show that, in 1998, 19 of the 27 members of the Network had achieved financial self-sufficiency (defined as operating income/operating costs) and a further two were close to doing so. The average portfolio at risk (outstanding balance overdue more than 30 days/total loan portfolio) was 3.7% (See Appendix 2 for more detailed statisitics).

Performance Overview

	Staff/Affiliates as of 01.99	Disbursed loans 1998	Delinquency rate 1998	Sustainability rate 1998
Fundusz Mikro, *1994	64/33	10.700	2,3%	operational break even!
FINNVERA, *1999 *71 as Kera, *96 micro loan program	400/15	3711 (micro loans)	9%	n. a. (80% for all loans)
ICOF, *1973	3/0	32 ①	3,8%	50% ②
ACCION *1961 worldwide, *1991 USA	7 (N.Y.)	217 (N.Y.) 888 (total U.S.)	13,2% (N.Y.)	45% (N.Y.) 13 – 58% (U.S.)
ADIE, *1988	80/14	1629 ④	6% ④	20 – 30%
Working Capital, *1990	10/4	270	14%	20%
Glasgow Regeneration Fund *1993	4	46 (04.98 – 03.99)	n. a.	0%
Women's World Banking *1989	23/1	21 ③	0%	0%

① – from own ressources; 90 loans in total counting funds in management and backoffice service ② – based on income through lending activity
③ – all packaged for bank partners ④ – including packaged loans for bank partners

4 Summary

Not every bank will want to lend in the high-risk micro-enterprise market. But for those that do, there are some interesting lessons from the experiences of specialist micro-lenders on how to lend in this market without incurring unacceptably high costs or running the risk of high rates of default.

A wide range of tailor-made loan products have been designed to meet the needs for risky micro-entrepreneurs. These include stepped loans, where borrowers are, effectively, assessed for a credit line, which is delivered as a series of small short-term loans, with each loan being conditional on the borrower's repayment history. These reduce the risk faced by both borrower and lender alike.

Fixed repayment loans, where no penalties are imposed for default but are allowed for in the interest rate and general charges, are a key element for some micro-lenders. But they are by no means universal. Micro-lenders that issue such loans find that they do not increase the level of default and have a positive effect on business survival rates.

On the whole, borrowers at this end of the market are prepared to pay higher interest rates – but only for products tailored to their needs. Most micro-lenders do not require security for the loans that they issue and those that do require more on loan guarantees than other forms of security. On the whole, though, they prefer to reduce the risks of lending instead.

Although group lending is often considered to be synonymous with micro-lending, it is only used by a minority of micro-lenders in Europe and the United States. Lending in this way can reduce the costs of payment collection and reduce the level of default through peer pressure.

Finally, there is a clear need for customer support as well as loans. Although whether or not this should be provided from the same institution is a matter of debate. People entering marginal self-employment often need extensive support and mentoring; while new and existing entrepreneurs have needs ranging from advice and training to detailed consultancy.

Attracting suitable clients is by no means easy, as many micro-lenders have found. On the whole the most successful strategies have been based on using other entrepreneurs to introduce new customers

This is, perhaps the main area where there are important differences between banks and specialist micro-lenders. In general, risk assessment is based much more on personal factors such as entrepreneurs commitment to their business and their business cash flow than it is on business plans. Indeed, some micro-lenders have developed some very sophisticated systems of risk assessment, that differ markedly from those used in bank small business lending.

Micro-lenders have developed a range of interesting techniques for managing risk. These include loan after-care, designed increase business survival rates. Incentives for prompt payment (e.g. entitlement to further loans; future loans at a reduced interest rate) have generally been found more effective than penalties for late payment. Finally, all successful micro-lenders operate a firm but fair approach to debt management. Many have had to learn this lesson the hard way, after incurring high rates of default. Some expect repayments to be made at a set time and place and contact borrowers within 24 hours of late payment. Where there is a genuine reason for non-payment loans are rescheduled; where there is not then immediate steps are taken to recover the money owed.

By using such techniques levels of default are contained to under 10 per cent. Those specialising in micro-credit and development credit had achieved between 41 and 116 per cent operational self-sufficiency.

Annexlist I

Annex 1: Case study of the micro-lender Accion New York
Annex 2: Case study of the micro-lender ADIE, Paris
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Annexlist II

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Benchmarking case-study

ACCION, USA

Date of visit: February 03 and 09, 1999

Executed by Jan Evers and Stefanie Jack, IFF, Elaine Kempson, PFRC

Objectives and vision

ACCION International's main objective is to fight against poverty through micro-lending. "What they (poor people) need to break free is a little credit - a loan as small as $75. Now they can get it. ...ACCION International is dedicated to bringing financial services to these smallest of small business people..."[1]

ACCION has declared as it's major vision to accomplish the above objective through achieving sustainability. This vision is based on three arguments:

- The total amount of money which is necessary to support poor people in the US and world wide is much higher than one organisation could raise from donors.
- The experience from Latin America where some of ACCIONs micro-lending initiatives became self- sufficient – in particular BancoSol.
- In addition, ACCION made the experience that using grant money from the government is dangerous because it is usually delivered under conditions for distributing which could prove unfortunate for a successful lending methodology.[2]

ACCION U.S. Initiative set itself the following objectives:

- IMPACT: To increase incomes, build assets and create jobs by supporting the initiative of self-employed women and men.
- SCALE: To reach enough micro businesses to have a significant impact on the economic revitalisation of distressed communities.
- SELF-SUFFICIENTCY: To develop a microlending model for the U.S. that is self-sustaining – able to cover its costs through fee and interest income.

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[1] ACCION Internet Sites, www.accion.org, Homepage

[2] Livingston Parsons, Senior Director ACCION U.S. Operations said in an interview during the case study at 3.02.1999 "stay away of state money because the conditions to get it destroy the methodology for successful lending". The only exception he made was money out of the CDFI fund.

Short history

ACCION International was founded in the year 1961 in Venezuela as a student-run volunteer effort. Initially they started their program as aid assistance and peace corps in Venezuela. Over the next ten years, ACCION started programs in three more countries: Brazil, Peru and Colombia, placing over 1.000 volunteers and contributing more than $9 million to development in some of the poorest communities of Latin America.

In 1973 ACCION staff in the city of Recife, Brazil started issuing small loans for supporting microenterprises. Within the next four years ACCION had provided 885 loans to small enterprises in Latin America. Within the next ten year ACCION helped start micro-lending programs in 14 Latin American countries.

At some stage in that process ACCION decided to concentrate its activity on lending and give up other assistance programs.[3]

In 1991 ACCION brought it’s programme to the U.S. Starting a micro-lending model program in Brooklyn, New York. Over the next five years, ACCION's U.S.Network adapted it’s Latin American lending model to the different context of the U.S. Today the U.S.Network has micro-lending programs set up in 6 American cities.

By the end of 1998 (10/98) the U.S. Network had disbursed cumulative
14 Million US$ to 5.110 low-income entrepreneurs.

Organisational structure

The head office of ACCION is placed in Boston, Massachusetts. The head office overseas currently a total of 26 programs. The ACCION head office involves 45 people. A President and CEO, Financial Controllers, a fund raising group, a group for Latin American Operations and a group for the U.S. Network Operations.

ACCION consists of a network of 20 Programs in Latin America[4] and 6 programs in the United States. In the US, each program operates independently, raises its own funds, does it’s own client marketing and sales procedures and operates it’s own financial controlling and even loan their product development. However, ACCION headquarters assist in providing human resource strategy development, in developing a communication strategy, in setting up a joined reporting and in fundraising with national organisations. They major incentive to be part of the ACCION network is the fame of the name (a international brand so to say) and as a

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[3] Livingstone: "From our experience Micro-lending organisations are either good in lending or in assisting"

[4] Programs in Latin America are currently placed in Argentina (one program), Bolivia (two programs), Brazil (one program), Chile (one program), Columbia (four programs), Costa Rica (one program), Ecuador (one program), Guatemala (two programs), Mexico (one program), Nicaragua (one program), Panama (one program), Paraguay (one program), Peru (one program).

consequence of a shared database and marketing strategy a strong public relation position.[5]

The US: network has placed it's programs in Chicago, El Paso, New Mexico, New York, San Diego and Texas. Within this network, information on the outstanding loans is shared within one database to deliver national figures. This research project has concentrated looking at the U.S. Network and in particular at the New York program.

The ACCION New York is structured as follows:

- The N.Y. program has a total staffing of 7 people. President and CEO of the N.Y. program is the first person to mention. One Office Manager who overseas the loan officers is in charge of book keeping, delinquency collection and loan administration. Two Loan Officers are in charge of client recruitment, client appraisal and client support.

- Further more Site Inspector is in charge of conducting all site inspections prior to loan disbursement and is in charge of delinquency collection after 30 days of delayed payment. One Receptionist is in charge of dealing with all incoming requests and of performing all orientation meetings which take place twice a week.

- Further more, in the future one New Business Manager will be in charge of all Marketing and PR activities of the office. This person will also be in charge to oversee 4 new volunteers which will start in the N.Y. office in due course. The volunteers' responsibility will be to help with client support, do support fund raising activities, to reinforce marketing and PR activities and to cover systems and technology problems.

Target Group and client profile

Target group and client profile ACCION U.S. Network

40% of all ACCION U.S. Network clients are women. 87% are members of a minority group and 50% of all clients do possess a high school education or less.

"They (ACCION clients) start their business because their sub- or minimum-wage jobs do not provide enough income to make ends meet, let alone dream of buying a home or sending their children to college"[6]

[5] For the US network, currently there are some plans developed to strengthen the ties between the programs. However, in March 1998 the New York program became complete independent of the head office in Boston and the question is if the independent programs share the commitment of the head office for stronger ties.

[6] ACCION US Network 1997 Annual Report, page 2

30% of all U.S. Network clients work out of a store front, 23% operate from the street or in a market, 39% operate a home based business. ACCION clients are typically in business for around 3 years, one out of 4 less than a year. 25-30% of the clients have the sole intention to rebuild a positive credit history with the programme

1.4.2. Target group and client profile ACCION New York

Target group, client profile, facts and figures, financial services and credit delivery methodology differ slightly in the respective programs. As the benchmarking team has concentrated on visiting and interviewing the New York program the following chapters will describe the situation in New York.[7]

ACCION New York works best for people who:

- Own their own small business
- Are committed to their business
- Are self motivated business people
- Can prove self discipline and commitment towards ACCION

> *"Clients of ACCION New York typically have lower than average incomes, with a median household income of $24,948 for a three-person household, compared to the national median of $41,043. The median asset level of clients' businesses is less than $3,000 and the median monthly take home income from the business is $1,200. 98% of its clients are Hispanic. Over 50% work in the service sector.*"[8]

Clients coming to ACCION New York are active in the following businesses: taxi driving (a large percentage of all group lenders are taxi drivers), street vendors, seamstressing, sandal making, hairstyling, cooking (catering), cleaning, and nursing.

45% of all loans in the New York program are taken as group loans, whereas 55% of all loans are individual loans. 42% of all lenders are women. 92% of these women are loan parents. 50% of all lenders use the income from the business supported by ACCION as the only income, 50% use it as an additional income.

ACCION New York targets people who have set up their business for at least one year. They do not support any start ups. However, this does not mean that the clients have to be perfect running businesses. The requested business experience is often on a marginal basis, for example a home based business and sometimes it is enough that the loan applicant has to prove "some activity" in the type of business without having been an entrepreneur himself. The crucial point is that there is not only a vision but a practical understanding about the product, the local market and the customers.

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[7] It is important to note that the New York program is the biggest of ACCION in the US, is one of only two US programs who provide group loans and went through some strong changes in 1998, in particular independence of the headquarter, a new C.E.O. and in many respects a turn around in portfolio quality .

[8] ACCION Internet Sites, www.accion.org, About ACCION, Meet our clients, ACCION New York

Facts and figures for the New York program

		New York Program	Total U.S.
1.	Number of loans disbursed since inception	2.066	5.110
2.	Amount of loans disbursed since inception	USD 6.568.594	USD 14.816.806
3.	Average loan amount	USD 1.264	USD 2.739
4.	Average loan term in months	7-15 months	not available.
5.	No of employees	7	
6.	Total number of loans disbursed in 1998	217	888
7.	Amount of loans disbursed in 1998	USD 956.444	USD 3.363.294
8.	Loan balance outstanding for 1998 (31.10.98)	USD 788.676	USD 3.344.228
9.	Administrative expenditure for 1998		
10.	Credit losses/Write off's for 1998	11% [9]	4,6%
11.	Delinquency rate for 1998	13,2%[10]	not available
11.	Income from clients in 1998		
12.	Re-financing costs (average)		
13.	Estimated rate of survived enterprises (after three years)		

[9] this (for ACCION standards) high figure is currently falling due to strong changes in the loan and collection policy implemented by the new C.E.O. in 1998 (see section 2) which is reflected in the Delinquency rate for all loans made after 30/09/97 of 8,1%.

[10] please note that ACCION calculates this figure (provisioning for losses) very careful: after 30 days of late payment the full outstanding loan amount (and not only the outstanding instalment) is seen as delinquent

Financial services and credit delivery methodology

Client recruitment

The New York program is known by the local population mainly through word of mouth. 80% of ACCION's New York's clients did learn to know about ACCION through word of mouth. ACCION is reinforcing the word of mouth process by an award system for all clients who refer a new client to the system (see section 2).

ACCION is distributing their flyers and information material through existing organisations of racial or religious minorities. Further more the local community is kept informed about ACCION through TV, newspapers, magazines and other publications. ACCION has started the attempt to work together with banks on referrals of clients who the bank does not serve. This however has not proved very successful so far. Further co-operation with several banks is planned.

The second step after distributing information material, flyers and advertisements is an information meeting which takes place several times a week in the New York office. These meetings are attended by between 5 to 15 people. 13,5% of all clients attending these information meetings end up with a loan disbursed.

One of the biggest problems of ACCION New York in the client recruitment is, to fight against the perception of being one of the uncountable loan sharks lending money in poor neighbourhoods in the US. This is one reason why at the moment word of mouth is so dominant for recruitment. Only if other clients tell that ACCION is no loan shark, people can trust and become new clients. Many clients of ACCION made very negative experience with money lenders before and are very careful in "risking everything again."

Credit delivery methodology

The first step for each client who is interested in receiving a loan from ACCION is to attend the first information meeting which is called orientation. The orientation takes place in English and in Spanish and has a duration of about 45 minutes. During this orientation clients receive information about the form of ACCION loans, administration details, costs of the loans, penalties if loans are not paid back in due time and loan collection procedure.

After the orientation meeting ACCION does hand out a loan application form which is to be completed by the client and supplemented by a number of "security documents" (regarded as the second step in the loan delivery methodology). The application form asks for personal details as well as business details. Further more ACCION asks for security documents as supplement to the application form.[11]. Important to note is that many of ACCIONS clients are not literate or feel insecure in writing. The loan officers

[11] Details see chapter 1.8. Risk Management

of ACCION are happy to assist in filling out the forms (without asking much questions why).

As the third step the loan officers conduct an intensive investigation on the clients financial standing. The loan application will be reviewed by checking on the credit history of the client, talking to the people which the applicant has appointed as personal and business references and by making a site inspection in order to visit and check the clients business premises. There is an officer centrally doing all the site visits, which gives synergies in travelling time.

Clients whose application is turned down will be referred to start up help desks or something alike. A new application can be handed in by these clients 6 months after the first application.

The fourth step is that the loan officer presents the loan application with all relevant details to the Internal Loan committee held every two weeks. The Internal Loan committee consists of all loan officers in the New York program, the office manager of the office and the President and CEO of the New York program. After the presentation of each loan application the committee votes.

Approximately 30% of all loan applications fall through this approval process. Should the loan application be above 15.000 US$ the credit decision will be carried to the external Credit sub-committee consisting of board members.

Once the loan is approved by the credit committee the client will be "walked to the bank" by one of the loan officers with a cheque and collects his loan (to make sure that they do not hesitate to use the cheque and know where the branches of the bank partner Chase Manhattan are).

Cost and terms of services

The current product of ACCION New York is a stepped loan to individuals. 50% of these credits are administered as group loans and 50% as individual loans. Minimum loan size of the New York office is 500 US$, maximum loan size 25.000 US$.

There are two different prices for group loans and for individual loans.

The annual interest rate for all loan products is 16%. Group administered loans have an additional service charge of 5%, individual loans 6%. This additional service charge is reduced directly from the loan amount handed out.

Late payment fees are calculated as follows:

Days	1-10 days delayed	11-30 days delayed	Each additional month delayed
Fees	US$ 20	US$ 30	US$ 20

A relative new product is a starting loan step of up to US$ 5.000. This targets the market of more advanced business men who found the small amounts of money not attractive enough to apply for. However, the loan conditions for these loans are tougher: a more advanced business with a strong cash flow performance is required.

Currently, it is investigated if there might be a potential for selling insurance products (in particular life insurance and business related insurance) in co-operation with a mainstream financial institution.

Loan administration and MIS

Loans to clients are issued with cheques paid out at the bank partner Chase Manhattan without further costs (in many US cheque cash shops fees are as high as 10%).

The repayment is done with vouches for deposit slips ("client coupons") witch are again issued by Chase Manhattan and can be paid in to every branch of Chase Manhattan. The amount is transferred to the account of ACCION at the next day. Bank statement are sent to ACCION on a daily basis (online). With this system ACCION is able to realise clients delayed payments within 24 hours is prepared to react immediately.

There is a DOS based database for loan administration which is used by the office manager. Although with this system ACCION is having some stability problems and problems to identify group administered loans, the system delivers a list of "one day late"-clients on a daily basis per responsible loan officer. This allows an immediate follow up by the loan officer. Currently ACCION US is investigating in new products for administration. The implementation of a new computer system is planned to take place next month.

Risk management

Credit worthiness evaluation

First and essential criteria for the credit worthiness evaluation is, whether the clients business exists at least one year. ACCION does not support any start up’s.

Further more the loan decision by the credit committee is carried by three major considerations:

a) Need for a loan
b) Pay back potential
c) Character of the client, entrepreneurial motivation

As mentioned in chapter 1.6.3. ACCION is conducting a very concentrated and sophisticated credit appraisal process. The process starts with the credit application form which asks for the following information:

Personal borrower information: Place of employment; Borrower take-home net income; Information on borrowers household; **Business information:** Location; description of business; number of paid workers; credit history of the business; assets of the business; business liabilities; loan request information; personal and business financial information.

As a supplement to the credit application form ACCION is asking for the following information:

a) At least two of the following bills: Telephone Bill; Cable Bill; Credit Card Bill; Con Edison Bill; Brooklyn Union Gas Bill; Letters from any government agency.
b) One of the following documents: Current Passport of native country; Resident Alien Card
c) Drivers License or Identification Card
d) Social Security
e) Original copy of home lease and business lease, if available
f) Current monthly Bank statement or a check from the account, if available
g) Credit Cards, if available
h) Co-signer sheet for individual loans and co-signer’s 4 most recent pay stubs

As mentioned in chapter 1.6.3. the loan officer of ACCION is doing a thorough review of the above material. Her or she will check the credit history of the client, will review his last bills, will talk to his landlord and will talk to some of the people which are mentioned as personal and business referrals in the application form. As a last step the clients business will be visited.

In order to summarise the scope and validation of data which is regarded by ACCION New York we would like to list all requirements to the client prior to approving his loan:

a) Orientation Form, attend first meeting with loan officer
b) Fill in loan application form and discuss financial analysis
c) Provide references
d) Provide ID
e) Allow inspection of business site
f) For groups confirm strong sense of solidarity and joint liability
g) Credit evaluation
h) Landlord reference
i) Liens on vehicles

Ensuring payment and debt recovery

The debt recovery procedure of ACCION is very standardised and follows a pre-structured path. The office manager receives bank statements on a daily basis and consequently can track delayed payments after one day. A default list is printed by the office manager every day and distributed to the loan officers on a daily basis. Once a week a debt collection meeting is held, which is attended by all staff dealing with loans.

Should the client be delayed with his payment for one day, he receives a telephone call from his loan officer reminding him to pay. Should payment not be received the next day a first letter will be issued to the client with a copy to the co-signer. As of day one for delayed payment a "Late payment fee" is charged. (see above)

The loan officer is in charge of chasing the client with telephone calls and letters for the first 30 days of default. Should there be no success in collection of money after 30 days the collection officer (at the moment the office manager) will take over from the loan officer after and be responsible for collection of money and chasing the client. "*A different voice being in charge of the money collection very often makes things progress*"[12]. Tougher letters will be sent by the office manager, he will call the client and visit him and his business personally.

Should the payment not be received after 60 days the account will be recommended for legal action and the case will be brought to court.

In 1998 a couple of tighter collection procedures were implemented by the new CEO and seem to prove successful. One of them is a weekly collection meeting were loan officers, collection officer and the CEO discuss trouble cases and the status of action.

Covering losses

For the case of a defaulting loan, the main source for covering losses is the liability of the guarantors: for group loans this are the co-borrowers which depend on further access to credit and therefore have to make pressure on the defaulted borrower to pay back or taking over responsibility for pay back themselves. Individual loan ACCION asks for a co-signer who serves as a guarantor for the loan. Requirements on the co-signer are that he must have a continuous working history (at least two years working for the last company) and that he must get paid by cheques in order that his salary could be garnished in case the loan is not paid back in due time.

Should the borrower not be able to find a co-signer he has to prove personal or business assets and use those as a guarantee. A UCC liens will be issued on assets in this case.

A group loan is secured by the group members who guarantee for each other to pay back if one of the group members defaults. For taxi drivers a vehicle liens is issued.

[12] As mentioned by the loan officer Evelyn Lassalle and her colleague during our interview

Should the loan be higher than 4.000 US$ collateral in form of assets are requested. However, collateral has proved not very successful in covering losses due to low market prices of used parts and high transaction costs in the selling process. Therefor collateral stays mainly a psychological security.

Sources of funding and operational and financial sustainability

ACCION New York is in the situation of a fairly unlimited loan capital due to the pressure the Community Reinvestment Act (CRA) is making on banks to care about local investments.[13] In total there are 68 major banks which lend money to ACCION. The prime lending rate in U.S.A. is between 7% and 8%. Due to the CRA banks are lending money to ACCION for an interest rate of 3% to 4%. In addition, ACCION can afford to ask banks for a share of 5% to 10% of the loan money given as a support for lending to clients who are refused by banks.

In addition, ACCION's capital is raised from co-operations, foundations and individuals, - 90% of these donations are raised from large donors, only a very small amount of the money is raised from individuals.

In 1999, the Community Development Fund Institution (CDFI) will also finance an essential amount of money for ACCION New York.

Nevertheless, currently 45% of the operational costs and loan losses of ACCION New York are covered through their own income earned by lending money. The remaining 55% is covered through donations.[14] For the financial year 1997, the six US programs of ACCION range in terms of self-sufficiency between 13% and 58% with the New York program at second place (38%).[15]

Human resources

For the whole ACCION US Network the quality of loan officer knowledge, experience and general staff quality is an issue for improvement. One important aspect is the high staff turnover seen the last years and a burn out syndrome.[16] As a result a policy for incentive programs and more support and training is under implementation.

Currently, ACCION New York implements an employee incentive system based mainly on the quarterly portfolio quality and loan growth. The incentive is responsible for 10-20% of the salary.

[13] According to Terry Ludwig, C.E.O. and President of ACCION New York

[14] Quote Terry Ludwig, C.E.O. and President of ACCION New York

[15] See the ACCION U.S. Network Annual Report of 1997, page 4

[16] according to Livingstone Parsons in our interview

In addition, a scheme to link the CEO's salary with crucial performance indicators as portfolio quality is under discussion. This shall prevent experiences, where loan turnover is dominant for performance appraisal.

The challenge in finding efficient loan officers is, that they should know the type of clients and their language and also need to have some formal financial qualifications. Currently, ACCION New York has put more importance in finding staff with clients knowledge and being able to talk the language of the clients rather than staff with financial background[17]. This however requires more training for the staff.

Co-operation with formal financial sector

It was already described that ACCION New York co-operates with banks in the following areas:

- Refinance (63 banks)
- Cheque issuing to clients (CHASE Manhattan)
- Instalments payment by clients (CHASE Manhattan)

In addition, potential schemes to get more referrals of clients by banks are analysed. However, the biggest obstacle seems to be that most potential clients of the program do not use banks at all or do not get to the point of discussing a loan appraisal with a bank loan officer who could refer them.

Non-financial services such as Business Advisory Services (BAS)

There are no general support schemes undertaken by ACCION New York apart from a general job descriptions of the loan officers who should be able to help the clients being aware of financial trouble ahead of time and being able giving advice for improvement.

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[17] for example, the former jobs of two loan officer – which the research team evaluated as very efficient in their jobs, have been supermarket cashier (2x) and some work for a credit collection agency

Benchmarking case study[1]

ADIE, Paris France

(Association pour le droit à l' initiative Economique)

Date of visit: January 10-11, 1999

Executed by: Jan Evers, Klaus Svanholm Nielsen

Objectives and vision

ADIE is an association founded in 1988. The inspiration for which came from Grameen Bank in Bangladesh[2]. ADIE, or the people behind it, wanted to create a micro-lender in France to help individuals excluded from economic activity. It is important to bear in mind that ADIE see itself at least as much as a social organisation as a economic sustainability as a short time prime goal.

Mission

- To help excluded individuals to start their own firms
- To provide loans to non-bankable people and to make them bankable

ADIE has two main instruments:

- Supply of micro-loans with a low rate of interest (6,5% for all loans + 3% initial fee[3]) and
- intensive support programmes to ensure a high rate of survival of the financed new-starters.

ADIE wants to continue to grow rapidly. According to ADIE the number of loans is expected to increase from 1800 in 1998, to 2400 in 1999, to 6000 in the year of 2001 and to more than 10.000 per year later on. In 1999, ADIE wants to implement a programme of peer lending. By the year 2001 about 1000 out of the 6000 loans are expected to be peer loans. In 1995 the number of loans was only 700.

More people will be employed to deal with this expected expansion and productivity is planned to increase by 30%, from 32 loans per year per loan officers to 42[4], in the coming years.

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[1] This case study was sent as a draft to ADIE in April 1999, checked by the management and revised in June 1999 in accordance with their comments. It is, therefore, an externally evaluated case study which has been accepted by the management of the organisation.
[2] Presentation publication by ADIE
[3] All loans pay 6,5% interest rate. According to French law – usury prevention - the rate of interest rate at the time of this study must not exceed 11% p.a. included al cost and fees for the client
[4] Credit Solidaire 2001 - Plan Triennal de l' ADIE, October 1998

Short history

ADIE was created in 1988 and unlike other organisations, e.g. Fundusz Micro in Poland - ADIE had nostart-up capital. The association was, and is still, forced to raise capital to finance its lending activities and to cover its costs.

According to the legal framework in France (as in many other European countries such as Germany and Spain) loans can be only be issued by organisations which have the legal status of a bank. ADIE received authorisation from the "*Comité de la Reglementation Bancaire*"[5] which allows them to make loans from equity. However, ADIE expanded its lending activities faster then it could increase its equity and, therefore, needed extra loan funds.

In 1994 ADIE started to make partnership agreements with banks to solve this problem. They currently have agreements with twenty-five banks. Under these agreements, the bank issues the loan after ADIE undertakes a positive credit worthiness evaluation. The bank receives the 6% interest and a 70% guarantee from ADIE. ADIE receives the 3% initial fee. In 1998 the banks managed 75% of all ADIE's loans, and the remaining 25% stayed within ADIEs own loan portfolio.

These partnerships have enabled rapid growth, from 851 active loans per year in 1996, to 1299 in 1997, and 1600 in 1998. In that time the number of people employed by ADIE increased from 30 to 85.

Organisational structure

ADIE has 14 branches (delegations) covering most of France. According to ADIE's business plan – "*Credit Solidaire 2001*" - the whole France will be covered in the near future and the number of branches will be increased. The structure is clearly decentralised and all loan decisions are made by regional delegations. There are quarterly meetings of the regional branch managers.

Each delegation has a regional manager and a number of loan officers as well as a credit committee. According to Credit Solidaire the numbers of agents de credit was in 1998 24, the numbers of charge de mission (the highest ranged of the two) 32 , in total 56 persons.
In addition, ADIE "employs" 300 volunteers - often retired professionals – mainly to support clients in areas too time consuming to be covered by the loan officer and to participate in the credit committee.
AFter one year training pperiod, one loan officer is responsible for 70-80 active clients[6]. They are currently attempting to raise this number in order to increase efficiency.[7] A loan officer typically conducts 300 client interviews per year, resulting in 40 new loans. He is also in charge of the follow up of the client.

The committee of credit approves all loans in the region. The committee normally meets several times a month. The members of the credit committee are volunteers - e.g. former professionals, such as bankers, lawyers and managers. In the region of

[5] see letter of them to Ms. Nowak, dated 18.02.1991
[6] According to Eric Mezieres, in charge of ADIE research, interviewed 12.01.1999
[7] According to Sophie Chabanel, regional manager in Ile de France, interviewed 11.01.1999

Ile de France, 5 to 10 loans are approved per weekly meeting[8]. Before approval a loan officer presents the loan application to the committee. The client does not participate.

Target group and clients profile

One of ADIE's main client groups consists of persons on RMI[9]. In 1997 44% of borrowers were on RMI: 27% were long-term unemployed; the other were under short term unemployment[10]. ADIE wants to help all vulnerable groups, such as persons coming out of prison, women in rural areas, young people from disadvantaged areas as "*Bonliieue*" and gypsies. Summarised this means that ADIE wants to make the poorest of the poor bankable.

Because most of ADIE's clients are receiving social benefits ADIE has to constantly adjust it's procedures because of legal and social changes imposed by the French authorities. According to Maria Nowack, president of ADIE[11], one of the main task for ADIE is simply to follow and adjust to new laws and rules.

Some key-figures for ADIE

1.	Number of loans disbursed since inception	5.422[12]
2.	Amount of loans disbursed since inception	FF 108.500.000
3.	Average loan amount	FF 22.000[13]
4.	Average loan term in months	20 months[14]
5.	No of employees	80
6.	loans distributed in 1998[15]	1629
	Active borrowers	3300[16]
7.	Loan amount handed out/ issued in 1998	FF 28.000.000
8.	Loan balance outstanding for 1998	FF 44.000.000[17]

8 see above
9 Social welfare received by non-assured unemployed persons. In 1997 the ACCRE was suppressed leading to a decline in the loan demand for this group.
10 ADIE - Rapport d'activité 1997
11 Interview the 11.01.1999
12 figure results from database research 12.02.1999
13 Maximum loan size = F.fr. 30.000
14 maximum 24 month
15 for 1996: 851, for 19997: 1279
16 number given by ADIE (Bruno Gaultier) for the end of 1998
17 25% are loans issued by ADIE itself, 75% by its bank partners but guaranteed by ADIE

9.	Administrative expenditure for 1998	FF 22.000.000
10.	Write offs for 1998	1%[18]
11.	Delinquency rate for 1998	6%[19]
11.	Income from clients in 1998	FF 1.800.000
12.	Re-financing costs	0
13.	Estimated rate of survived enterprises (after three years)	75% (after two years)[20]

Productivity[21]	32[22]
Number of loan per loan officer, total	59

The figures on how ADIE's loans are served are based on calculations made by ADIE. The percentages indicate the expected situation for a loan in its whole lifetime. Please note that figures from banks, if publicly available, normally describe the situation for specific time frame e.g. end of financial year, ADIE's figures are not directly comparable with figures from credit institutions. (See below for more information on the distinction between loans from ADIE’s own funds and guarantees to bank).

ADIE estimates that on average it needs 1.982 EURO (13.000 FF) to cover loan transaction costs and 305 EURO (2000 FF) to cover the risk (of that are for the packaged loans 30% taken in charge by the bank partners). The transaction costs can be devided into 4000 FF for transition (last interview, credit committee), 5000 for training and advice and 4000 FF for the development of the institution. The last cost factor will decrease because the institutional framework is developed. In addition, it has to be kept in mind that the costs for advice and support are correlated to the difficult environment for entrepreneurs in France.

[18] write offs since beginning: 3%
[19] since beginning: 10%
[20] from an evaluation study in 1998 with all loans from the beginning without loans of the last two years. In 1995 a study was undertaken with a survival rate of 66% after two years.
[21] Number of loans per year / number of loan officer loan officers = Charge de mission (CM) + Argent de Credit (ADC)
[22] According to the mentioned report "Credit Solidaire 2001", the productivity will increase to 42 or by 31%.

Financial Services and credit delivery methodology

Client recruitment

Like all micro-lenders ADIE get its clients through various channels.

Currently, the biggest proportion of clients come for most branches either by media attention or enterprise agencies. ADIE's experience suggests that people who respond to information in media are less serious and lead to fewer loans in comparison with other acquisition strategies.

Other clients come from social agencies and chambers of commerce and enterprise agencies[23]. ADIE's experience of clients from social agencies and chambers of commerce is mixed, because these people often have severe problems which the referring organisation "*just wanted to get rid of*".

One example of an effective instrument to target the market of unemployed is distributing flyers at the location where unemployed have to fill in forms for exoneration of social insurance.

Current products and plans for future products

ADIE currently provides mainly one financial product: credit for investment and working capital, with a maximum amount of 30.000 FF and a loan period of two years. This loan is either issued by ADIE itself or by its bank partners. The conditions are similar.

In some regions ADIE issues grants and subsidies refinanced by the local government who rely on ADIE as an effective distributor. One other product are "*honour loans*": loans with equity character.

An interesting product is the borrowing of material: as ADIE discovered that many entrepreneurs need the same things for starting up (transport car, computer, market equipment), they start to recycle them of failed entrepreneurs and lend them out.

A group lending model is planned and is currently being piloted for client groups from similar social backgrounds or particular neighbourhoods (which, therefore, provides the basis for networking and group dynamics), in particular for gypsies, former prisoners and young people from the beanlieu.

[23] It seems to be very different from region to region where clients come from. For example, in the inner-city area of Paris (branch Ile de France) it is estimated that 7% of clients are referred by social agents, 17% of chambers of commerce and enterprise agencies, 30% through media attention and the rest by "word of mouth". At the same time in a much smaller city like Strasbourg, more then 50% are referred by enterprise agencies. For the region Ile de France, very few clients are referred by banks in other areas co-operation works better.

Credit delivery methodology

The loan procedure is again quite different from region to region. In the future, the job of an co-ordinator is implemented who visits branches regular to harmonise procedures and do an internal best practise exchange. However, a more or less typical loan procedure is as follows:

a) The client gets information about ADIE

b) The client contacts ADIE, normally by phone (served in some regions with high demand by volunteers)

c) The client receives a form of 6 pages with detailed questions about income, rents, civil status, marriage, children, time of unemployment, project description etc. The file is sent back to ADIE.

d) A loan officer interviews the client. To date, these interviews take around 2 hours per client

e) The loan officer discusses the application with another loan officer in the delegation (branch). The names of the guarantors have to be settled. If the branch agrees the loan, the application goes to the Committee of Credit

f) The loan officer presents the application to the committee

g) The client is informed of the decision

h) The loan is either from ADIE's own funds (25%) *or* a bank loan guaranteed by ADIE (75%). In both cases the client has to open a bank account

i) The loan officer enters the client's file in the computer database

j) If the loan is from ADIE's own funds the loan is paid out from the headquarter in Paris, transferred by a bank account

k) If it is a bank-loan the client goes to the bank and signs a contract. The bank will pay out the loan into the account and repayments are sent directly to the bank by the client

l) Normally the loan is available to the client within 15 days.

m) Repayments start 2 month later.

According to ADIE an average application takes 4 hours before the approval of loan. The time used for direct banking activities is about 1 hour. But the most time-consuming element takes place after the approval. In average each client receives 15 hours of support in the following two years.
On average, the loan officer gets in touch with the client once per month to check their situation. The important objectives are a) to check if the client meets the administrative demands regularly (due to the high bureaucracy requests to entrepreneurs and b) to find out if they made or lost money in the previous month. This meeting have both a fire-fighting and a preventive support strategy.

Besides the direct support, ADIE organises entrepreneur circles where clients meet to exchange their experience and receive training. However, from region to region success rate of invitation varies between 1-30%.

Cost of services

All loans cost 6% interest with a 3% initial fee. There are no membership fees.

Loan administration and MIS

Once the loan officer enters the client's file into the computer database the loan can be monitored by ADIE's central administration. If the loan is from ADIE's own funds the client receives a specific instalment document. ADIE will normally instruct the client to repay the loan by using automatic payment systems through banks. If the loan is bank loan ADIE does not gives this instruction and the client has to go to the bank and sign a loan contract.

All the branches are connected electronically to the headquarter in Paris. Any changes to loans e.g. delays or rescheduling must be registered in the central computer system. The loans issued by bank partners are also registered in this database

Risk management

Credit worthiness assessment

Decisions on credit worthiness are based on

- the business idea
- the client's personal background
- and the projected cash-flow.

In the telephone interview, the loan formula is applied and these criteria will be assessed prior to the interview with the loan officer. Typically, the business will be visited. During the telephone interview it is made clear to potential clients, that the formula is not for selection but for general understanding of the idea. In general, the interview style is a "*teaching approach*"[24]

Finally the loan officer decides if the application is strong enough to be evaluated by the credit committee and the branch manager has to co-sign. At that stage the loan application is decided by the committee of Credit.

The following gives an impression of the selection system. Of 100 initial enquiries about 9 people will receive a loan.

[24] According to Chabanel, see above; "we make sure that they understand what we are doing and what we are looking for".

Clients call (100 persons) → ADIE send a file to clients (40 persons) → clients send the file back to ADIE (30 persons) → personal Interview (28 persons) → branch approves loan (10 persons) → Committee of Credit approve loan (9 persons)

To increase the quality of loans ADIE is careful with lending to people who want to start businesses in very difficult and competitive sectors, such as market-selling and imports and exports.

Ensuring payment

Payment control is done by the central office in Paris where one person checks late payment and regularly provides branch managers with an e-mailed list of all late payments. These are followed up by loan officers.

If a payment is 5 days late, the client gets a letter and a telephone call. If a loan is delayed by two instalments in succession, or three delays in total, the loan is registered under a specific item in the main system. If one or two instalment are late the loan will normally just be prolonged and no specific action will be taken.

Repayments are discussed In regular meetings between the branch manager and each loan officer. If further action seems appropriate, the responsibility moves from the loan officer to an internal repayment officer. The guarantors are involved as a last resort to put pressure on the client.

According to a branch manager, the repayment system "*is not very formal but very reactive".*[25] However, there is no punishment for late payment and for the loans issued by bank partners, information about late payments can be deferred by one month due to bank practices (there is not always a separation between ADIE clients and automatic late payment listing).[26]

ADIE demands that the client sends some kind of a monthly report. According to ADIE these reports have a positive impact on the ability to catch potential defaults in an early stage.

Covering losses (collateral or security)

In order to reduce risk each client has to name up to 5 persons who will guarantee 50% of the loan. The function of the guarantors is to create a "*pressure*" or circle of responsibility around the client. Only in very few cases does ADIE actually call on guarantors, because the cost will always exceed the value of the guarantees.

ADIE does not use ordinary private collateral, such as houses, cars. They do, however, take trucks and lorries financed by ADIE as guarantees. Personal guarantees are not used because all loans are personal loans with no limited responsibility. It is however very rare that ADIE uses this option.

[25] et cit.
[26] According to Mezieres, see above

Source of funding and financial sustainability

In 1994 ADIE made its first agreement with the bank sector. As mentioned above this agreement has made it possible for ADIE to expand its activities very rapidly. However, the agreement has probably not improved its financial self-sustainability. The bank-loan does not affect ADIE's liquidity but for this facility, *ADIE pays relatively high funding costs*, because the bank receives all the interest payment (6,5%) from the clients. Furthermore, ADIE must guarantee 70% of the loans. The agreement between ADIE and the banks ensures ADIE a start fee of 3%. For 1200 loans in 1998 (75% of 1600) on average FF 22.000 this creates an income of around FF 0,8 million.

25% of ADIE's loans are made from their own loan funds. ADIE generates 6,5% income from interest and 3% fees on these loans. For 400 loans with the average size of 22.000 FF this would make 0,83 million FF (regardless the bad debts around 10%).

Even if ADIE receives all the interest paid, the gross income can be estimated at 1,7 million FF. This level of income can not cover operational costs of more than FF 20 million in 1998 but it would cover the bad debts (estimated at 2,52 million FF[27]). (It has to be mentioned that precise figures on income are not directly available from ADIE's publications).

Using Elisabeth Rhyne's terminology, ADIE should be classified as an institute of level one of financial self-sufficiency. *"Revenue falls short of operating expenses, resulting in a continuing need for grants*[28]". ADIE openly admits that economic self-sustainability can not be reached under the French interest rate law and other difficulties created by the business environment.

It is, therefore, important for ADIE to ensure a continued flow of new subsidies. In 1998 ADIE got FF 5,8 million from the EU, subsidies from the French State were F.fr. 6,6 million. Finally, the local authorities gave F.fr. 6,9 million. In total F.fr. 19,3 million[29].

In addition to funds from public authorities ADIE also receives funds from a large numbers of other organisations. According to ADIE the work involved in keeping all the 250 funding partners[30] happy is substantial.

[27] 10% of the value of own loans of 8,8 million FF(400*22.000FF) makes 0,88 million FF and for the 10% bad debts in the 70% guarantees to the bank loans worth around 26,4 million FF this would be 1,84 million FF.

[28] *Otero, M/ Rhyne, E.: The New World of Microenterprise Finance – Building Healthy Financial Institutions for the Poor*, Kumarian Press, West Hartford, page 18

[29] Figures are from Credit solidaire 2001

[30] According to Maria Nowack, the president of ADIE interviewed at the 11.01.1999

Benchmarking case study

FINNVERA

Helsinki Finland

Date of visit:[1] February 18-19, 1999

Executed by: Jan Evers, Klaus Svanholm Nielsen

Objectives and vision

KERA (now part of FINNVERA) was founded in 1971 by the Finish state. Initially, KERA[2] acted as an instrument to promote economic progress in the less developed parts of Finland[3]. Later on, their activities were expanded to include the whole nation. Today FINNVERA is an integrated and important player in the financial market in Finland and is well known nation-wide. FINNVERA is one of the four main suppliers of financial bank-capital to micro-enterprises in Finland. On January 1st 1999 FINNVERA was created by merging KERA, the Finnish Guarantee Board[4] and some other public financial organisations into one company.

FINNVERA operates as a "niche" bank (without being a bank – see below) by providing loans to two main groups:

- new firms and SMEs[5],
- selected groups, such as women- or micro entrepreneurs.

As FINNVERA distributes different products (loans, guarantees, venture capital) to a range of different types of clients (micro-enterprises, start ups, SME) the study focuses on FINNVERAs lending activities related to micro-enterprises[6]. These programmes were provided only by KERA and, consequently, this report refers to KERA in relation to all of these activities in the years prior to 1999.

[1] Apart from information sources quoted, the basis for this case study is the visit and the presentations of and interviews with Mr. Jukka Vilppo (Director Small Enterprises), Ms. Eeva Siurua (Business Analyst in Oulu), Ms. Anneli Soppi (Development Manager) and Mr. Esko Elo (Regional Director) and interviews with two of FINNVERAs clients.
[2] ALMI in Sweden and SND in Norway operate very much in the same way as KERA
[3] Because of Finland's size and geography (same size as the united Germany , but with only 5 million inhabitants) regional aspects play a central role in Finnish politics and administration
[4] Which also include the Export guarantee Board
[5] Small and medium sized firms with less than 250 employees, turnover of Euro million 40 and assets of Euro million 27
[6] KERA has a specific loan category called micro-lending, delivered to all business with max 5 employees (annual report 1997, page 2) with a special target programme for women. This definition of micro-lending does not correspond completely to the benchmarking project where we define a loan ceiling up to EURO 25,000 for businesses with less than 3 employees in the first years of business.

Micro- or women entrepreneurs receive between 15-20% of all new loans measured in euros, and more than 50% when measured in numbers.

FINNVERA operates in the financial market as a big nation-wide bank and has established a working style which, to a large extent, is similar to the banking sector. However, FINNVERA does not want (and is not allowed by the owner, the Finnish state) to compete with the private banking sector.

Short history

After it was founded in 1971, KERA became a nation-wide operation at the end of the 1980's. At that time the Finish economy was experiencing dramatic changes.

Finland was at that time quite dependent on exports to the Soviet Union. The collapse of this market, combined with a sharp drop in domestic activity, especially in the construction sector, created a dramatic economic crisis in Finland from 1990 to 1994. Most of the banking system went bankrupt and the Finish state was, as in Sweden and Norway, forced to support the financial sector with large capital inflows[7]. KERA was also affected by the crisis and reported losses. The unemployment rate is still high - around 12% - compared with less than 5% back in the 1980's, but the economic climate is slowly improving.

As a result of the banking crisis the potential conflict between KERA and the banking sector disappeared for a period and KERA could increase its activities in the first half of 1990s. Improvements in the economic situation has, once again, reinforced the potential conflict.

As a result FINNVERA has moved its market "downward". In 1996 a new type of loan, called "micro-loan" was introduced. In 1997 KERA introduced "*Loans for women entrepreneurs*". Around 25% of all new-starters in 1997 were using KERA although there were strong regional differences (e.g. 80% in Oulu and 20% in Helsinki).

The organisation receives three types of state subsidy for lending to SME's (for calculation of that benefit see chapter 1.9):

- Access to cheap refinance (due to a high credit worthiness with the state as a "*guarantor of last resort*")
- 50% coverage of bad debts
- interest subsidy for special loan programmes, - in particular the ones important for this study: loans to micro-enterprises and women entrepreneurs.
- KERA was lending two billion euros in 1997. Approximately 50% of these loans were classified as loans with low subsidies receiving only marginal public subsidy. The rest received more substantial subsidy, mainly in form of reduced rates of interest.

[7] According to OECD (June, 1998 p. 29) non-performing loans in the banking sector rose to 9,3 % in 1992. The expected final loss is estimated to FmK billion 45 (10% of 1993 GDP)

In 1995 Finland joined the European Union. This has not changed the overall framework for KERA/FINNVERA and is unlikely to change anything in the coming years.

Organisational structure

FINNVERA is a conglomerate of several companies and funds. It deals with many kinds of publicly subsidised financial activities, such as lending to SMEs, state guarantees schemes, venture capital. Furthermore, FINNVERA also provides legal commercial services through a sub-company.

FINNVERA employs 400 people, nearly all full-time employed. The majority are employed in the 15 regional branches, some of them are located in the same office buildings as state support agencies.

FINNVERA is not supervised by the Finish bank authorities and, consequently, is not obliged to follow the European banking rules, the CAD-rules. However, FINNVERA does calculate a capital adequacy ratio (19.1%) and observes the rules of bookkeeping on defaulting debts etc. laid down by the supervision authorities.

The lending activity (in the former KERA) is done by the 15 regional branches. Each branch has a manager and 10-15 employees. In the example of Turku (a city with 440.000 inhabitants), the branch consists of the regional director and thirteen staff. Eight of these employees are loan officer ("business analysts"), four of whom make up the back office ("financing secretaries") and one person manages the office and represents the branch to telephone callers and visitors. This means that 60-70% of staff are active in lending – a high ratio compared with conventional banking.

The structure of decision making for micro-loans is simple. If a loan is approved by a loan-officer, the branch manager has to confirm the loan. Each loan officer approves about 75 loans per year (used as a measurement of organisational productivity) and has around 200 active loans in his portfolio to manage.

It is important to understand, that the same loan officers manage all lending products to the different client groups: from micros with no employees to medium size enterprises with 250 employees. "*We wear different hats all the time*", says one loan officer. This makes a comparison in productivity with other micro-lenders nearly impossible.

FINNVERA does not use volunteers. The entire staff is paid on almost the same salary level, with a small spread from the top to the bottom of the wage hierarchy compared to the UK or central Europe. According to the annual report the average annual wage is FmK 200,000 (Euro 33,000), only marginally lower than salaries in the private banking sector.

Target Group and client profiles

FINNVERA has more than 20,000 clients. 82% of these are firms with less than 5 employees. According to EU classification 99% of all clients are SMEs. The average size of all loans are FmK 370,000 (Euro 63,000) while the micro-loans range from 3,300-16,000 Euro with an average of 12-13,000 Euro.

In 1997 more than half of all the 17.000 new loans were distributed to either micro-enterprises or women entrepreneurs. The size varies from industry to industry. The biggest loans are made in manufacturing and the smallest are given to entrepreneurs in private and business services.

The biggest sectors for micro loans in 1998 have been industry (31%), business services (17%), consumer services (14%), transportation (11%), retail (12%), and accommodation and catering (7%). Loans for women peak at consumer services (27%), retail (25%), business services (18%) and accommodation and catering (12%). Women consumer services consist mainly of beauty services and outsourcing of health care activities.

KERA[8] find it problematic that women-entrepreneurs tend to focus on traditional services, such as cleaning, retail, home-production of clothes and arts and crafts and are reluctant to start businesses in manufacturing. These traditional industries contain harsh competition and little potential for business growth.

Around half of all micro and women-lenders start business from home. The percentage is higher for women and people working in the service industry, and lower for men and people working in manufacturing.

KERA's client profile is similar to other micro-lenders: over 50% are home-based and involve marginal activities such as pottery, home made candles for gift shops, framing pictures, sewing for friends, running gift shops and cleaning. However, when asked about the most marginal business for loan disbursement the loan officers identified the above examples as the most marginal (expressing doubts whether lending to them made sense) while the US micro-lenders, in particular, saw them as the more typical client group.

Therefore, FINNVERAs micro-lending activities do reach marginal businesses which are some way away from being bankable (and – seen in traditional terms – from being profitable). The average client group, however, is much more upmarket, even if still unbankable. This different client focus is likely to be the result of a stronger social welfare system, and a different national economic basis (less service and self-employed oriented) but also a client recruitment system which is based more on referrals from mainstream banks.

KERA does not focus on ethnic, or educational background, and there are no statistics on client proportions. Having an income below the poverty line or being from a minority ethnic background are not big issues in KERA nor Finland in general[9]

[8] Eeva Siurua, business analyst in Oulu and Anneli Soppi, business analyst in Tampere
[9] Finland has one of the lowest immigration populations in the EU and has traditionally faced emigration to e.g. Sweden

Credit portfolio by industry December 31, 1997

Industry:	All loans	Women-loans	Micro-loans
Total manufacturing	***68%***	***12%***	***31%***
Total service industries	***30%***	***87%***	***65%***

Source: Annual report 1997 and special data from FINNVERA

Facts and figures about KERA

		Micro-lending activities in 1998 (1997):	All lending activities 1997 (1996):
1.	Number of loans disbursed since inception	< 8000[10]	
2.	Amount of loans disbursed since inception	Euro 47 mill.[11]	
3.	Average loan amount	Euro 12-13,000	Euro 62,000
4.	Average loan term in months	60	
5.	No of employees	n.a. (->)	285
6.	disbursed loans in 1998	3711 (5506)	
	Active borrowers [12]	(8,694)[13]	
7.	Loan amount of active borrowers	n.a.	n.a.
8.	Loan balance outstanding for 1998	Euro 138,2 mill.[14]	Euro 1 Billion
9.	Administrative expenditure	n.a.	1997: Euro million 20,5
10.	Credit losses	<2%[15]	1997: 2%[16] (5%)
11.	Delinquency rate	9%	
11.	Income from clients		1997: Euro million 71,8
12.	Re-financing costs (average)	n.a.	n.a.
13.	Estimated rate of survived enterprises (after three years)		85%

Source: Annual report 1997 and special data from FINNVERA

[10] in 1998 (1997), 2450 (3945) from micro-loans and 1261 (1561) from special loans to women
[11] according to the presentation during our visit per 31.12.1998: 83,9 and 197,9 million FmK
One Euro = 5,94573 FmK (figures are sometimes rounded)
[12] new clients/ new loans disbursed in 1998 (1997): 3.669 (5506) according to questionnaire filled out by Eeva Siurua, January 1999
[13] annual report 1997, page 5: "In 1997, Kera had a total of 8694 microloan customers"
[14] FIM 649 million for micro-loans and 173 million for special loans to women
[15] 2,4% for micro-loans and < 1% for women loans. However, due to the fact that the program is quite new and losses are given with a 1 year grace period, this figure has to be expected to increase
[16] The default rate is low for the moment because of a generally positive economic climate, furthermore many new loans have been provided to micro-enterprises and women in the last two years. FINNVERA believes that the long term default rate is around 5%. FINNVERA follows the rules according to financial supervision and measures the amount of bad debts on a group basis - not individually.

Other Figures

	Micro-lending activities in 1998 (1997):	All lending activities 1997 (1996):
Number of clients	n.a.	23,000
Average size (employees)	n.a.	5,2
Average size (turn-over)	n.a.	Euro million 1,1
Rejection rate	50% (30%)	n.a.
Productivity[17]	n.a.	75

Source: Annual report 1997 and special data from FINNVERA

According to the above figures KERA's lending activity has been decreasing for micro- and women entrepreneurs. The reason is that the loan activity was extraordinary high in 1997 when micro-loans and loans for women entrepreneurs were introduced. In 1997, 21% of loans were directed to micro and women entrepreneurs. The remaining 79% went to SMEs.

Financial services and credit delivery methodology

FINNVERA offers different types of loans. The most interesting types - in the light of benchmarking of micro-lending - are the "micro-loan" and the special loans to women entrepreneurs. These are the loans we are focussing on in this study.

Client recruitment

Compared with other micro-lenders, FINNVERA is well known by the public on a national basis. Their branches are normally located on "*the first floor*" and FINNVERA does not present itself as an ordinary bank.

FINNVERA estimates that 25% of all clients are sent to FINNVERA after having been in contact with the ordinary banking system. FINNVERA considers this connection to the banking system to be essential. The relationship between FINNVERA and the banks is often based on personal relationships, especially in the smaller towns in the rural part of Finland (outside Helsinki). FINNVERA encourages its employees to establish and develop personal relationships with bankers.

However, since implementing the scheme in April 1997 the demand for loans has been so high that KERA did not have to develop a structured client-acquisition strategy. They were simply overrun with demand, mainly due to raised awareness through media attention and word-of-mouth. A more active marketing approach is planned In the coming month.

[17] Productivity is measured as numbers of new loans per year per loan-officer

Credit delivery methodology

All decisions regarding micro-loans and smaller loans are handled by one loan officer and the branch manager, who approves all loans. It is worth knowing that FINNVERA does not use the term "loan-officer". They operate with business analysts and development managers. This indicates a strong industry orientation in the organisation. Each business analyst has a special area e.g. wood-processing or private business services for women. When a client contacts a branch he or she will be served by an expert in the relevant market.

Steps in the loan process:

a) **Application:** The applicant will have to fill in a loan-scheme, containing information about business plans, e.g. market description, prices, names of competitors, calculation of cost, personal experience in the industry. The applicant also has to give information about his or her private economic situation, e.g. rents, income, family, children, tax, so it is possible to construct a budget for both the firm and the applicant personally.

   FINNVERA does not expect a full scale business plan for micro loans, but some indication of marketing, competition and financial planning. However, if a client needs assistance FINNVERA refers them to the "*state business service centres*", organisations acting on behalf of the Ministry of Labour and the Ministry of Trade and Industry. Many of the branches of FINNVERA are located in the same building as these service centres. The centres provide a free two day consultation service to start-up businesses.

   General guidelines for application approval are: businesses employing 1-5 people with an entrepreneur working full-time in the business.

b) **Meeting:** The second step in the loan application is a personal meeting between a business analyst or development manager, normally at the applicant's business Here the applicants objectives and plans are checked.

c) **Analysis:** After this interview the loan officer produces a decision report. FINNVERA has five different schemes dependent on the size and nature of the application. For micro-enterprise and new-starters FINNVERA uses the same and most simple scheme. FINNVERA always checks the applicant's credit record at a nation-wide bureau. If there are unpaid debts or bills, the loan will normally not be approved.

   The criteria for approval are based on the profitability, the company's development potential and the personality and character traits of the entrepreneur.

d) **Decision:** The final approval is done by the branch manager. He or she will normally spend 5 minutes on each application and normally the pre-decision will be followed. This step is important because it gives the manager a chance to control the work of the loan officers. It also reduces the risk of nepotism or bribery (probably not a real risk in the case of micro-lending in Finland). Furthermore, it means that the manager shares responsibility for the risk of default.

e) **Follow-up:** Each year FINNVERA receives a financial statement from the client's tax officer. In addition, clients are asked to fill out an annual report (from which he receives feedback, including computerised ratios with industry comparisons from FINNVERAs own customer basis). Both reports are the basis for checking the soundness of the client and the need for intervention. Apart from that, there is no general follow up policy.

According to FINNVERA[18] the cost (in time) of handling small loans are substantially smaller than the time spend on bigger loan application. For bigger SME-loans FINNVERA sometimes has to negotiate with banks and, consequently, spends much more time.

If the effort for one loan decision is measured in time units, we estimate the following: normally a micro-loan is decided after a 1-2 hours site visit, a ½ hours analysis work by the loan officer, and 5 minutes of the regional manager's time, plus the transport time for the loan officer. For the loan officer it is, of course, important that he or she organises the client-visit efficiently.

As quoted above: in 1998 it is estimated that every second application was approved for a loan.

The main differences between KERAs lending approach and that of the banks' in relation to their delivery methodology were:

- They do not use guarantees, the focus on profitability and development potential is not disrupted by security aspects[19]
- They specialise in delivering only SME finance
- The recruitment strategy and training for FINNVERA employees focuses on company financing and on qualifying for various aspects of banking business.
- Site visits: loan officers go to the client's business place and this is seen as the heart of the credit worthiness evaluation process[20]
- Learning approach: the loan officers' industry specialisation and the construction of a specialised SME industry database with each client means that there is an ongoing learning process about relevant markets.
- Crisis approach: due to a lack of collateral they take a very active approach in crisis situations: once they have assessed the chances for turnaround they put a rescue strategy in place if it seems likely to be successful (further details on this subject are lacking in our study)

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[18] Mr. Elo, Regional Manager in Turku (Åbo)
[19] Mr Elo: "Looking to collateral disturbes the concentration on the main thing: sustainability and profitability of the business idea".
[20] The following detail is interesting: This feature is often used by the loan officers in the banks if clients later on apply for a loan in the bank. The loan officer in the bank makes contact with the loan officer in FINNVERA to get more personal information about the client as the banks do not visit their small clients and consequently the banks have a weaker knowledge of the client and the market.

- Atmosphere with customers: friendly not distant atmosphere[21]
-

Cost and terms of service (fees and interest rate)

The interest rate FINNVERA charges of clients is fairly low. It varies from 3.2% to more than 7% (EURIBOR 3.2% (Jan. 99)+ spread (0,5% for women loans and 1% for micro loans). The lowest rate is paid by disadvantaged clients – as micro credits - in less developed areas.

It is important to note that FINNVERA does not ask clients for any kind of risk-premium on small and/or risky loans. (However, as described later a risk-premium is calculated and charged to the state.) On the contrary micro-loans and loans to entrepreneurs are the cheapest, because of government subsidies.

The terms of a micro-loan or a loan to women entrepreneurs are as follows:

- Maturity is 5 years with a one year grace period
- Biannual repayments
- Interest rate is 6-month EURIBOR (3.2% Jan. 99) without margin for women entrepreneurs and with a margin of ½% for micro-loans
- A front fee of 2% or minimum Euro 50 at the first disbursement
- The loan amount is between Euro 3.360- 16.800
- No collateral usually except for a personal security by the entrepreneur in the case of a limited company as a beneficiary (20% of the loan amount)

Loan administration

All loans are administered by a central unit inside FINNVERA. The system provides the loan officers and the managers with information about the loan-portfolio and default rates and so on. The administration of loans seems to be similar to the systems used in the banking industry apart from not delivering personal bank accounts to handle repayments.

We have not investigated the database and MIS of FINNVERA so far.

[21] as one loan officer said: "we see us more in one boat while bankers are much more distant" ... "we sit at their kitchen table in their home-based business and discuss the business serious as any corporate client ... – they are still a company for us"

Risk management

Credit worthiness assessment

As mentioned above, the loan officer will always contact a nation-wide credit bureau before approving any loans. Moreover the loan officer controls the personal budget plan and the business plans made by the applicants. Furthermore, the loan officer visits the entrepreneur at his or her home/business premises. According to FINNVERA only 50% of all loan applications are approved.

In the files about the clients FINNVERA uses a scheme based on the following assessments with five grades in different aspects:

	- -	-	0	+	++
Entrepreneurship					
Idea of product					
Competition					

Furthermore, FINNVERA separates clients into five risk groups: **A;B1;B2,B3,C**

Clients are also divided by geography**: I,II,III**. Group III is located in the most remote regions.

FINNVERA's assessment pays strict attention to the specific conditions in the different industries – supported by a in-house database. This is, of course, more important for bigger loans than for micro loans and loans to women entrepreneurs.[22]

Ensuring payment and debt recovery

Every month the central loan administration system reports delayed repayments. After two weeks FINNVERA sends the first letter to the borrower. If he or she does not react to the first letter, letter number two will be sent two weeks later. If that does not help FINNVERA will take legal action against the debtor.

FINNVERA does not normally take cases all the way through the legal system because of the high cost. They view these procedures as necessary to avoid moral hazard from the clients. If FINNVERA feels that the clients are being unfair or trying to cheat, full legal action will be taken.

Non-served debts will also be reported to a credit reference bureau. According to FINNVERA most borrowers with delays contact FINNVERA before legal action is taken. Often FINNVERA and the troubled entrepreneur make an agreement and postpone the missing instalment by prolonging the loan.

[22] FINNVERA is a public organisation and consequently the client can and does complain about decision made by the loan officers. However, it is seldom that a decision is changed, but it shows that FINNVERA is not considered to be a 100% market-orientated organisation by the clients and the public in general.

Every year FINNVERA receives annual reports from all clients from the tax authorities. Furthermore, all FINNVERA's clients have to complete and send an annual report to FINNVERA. On the basis of these reports FINNVERA gives feed-back to all their clients on industry development and how they compare with their competitors.

Covering losses

FINNVERA has a special arrangement with the Finnish state. The state has guaranteed 50% of all loans. In 1997 KERA received nearly Euro 10 million in credit compensation from the state. FINNVERA does not use and is not allowed, according to governmental regulations, to use normal collateral, such as real estate. The reason for this limitation is a desire by the Finnish state to avoid direct competition between FINNVERA and the banks. According to FINNVERA this restriction can also be advantageous because it focuses the loan officers' attention on the entrepreneur and his project rather than on collateral.

Source of funding and operational and financial sustainability

In 1997 KERA Corporation's main income sources were the following[23]:

Sources of income	In million FmK	In million Euro
Income from clients (interest and fees charged from clients)[24]	385,6 + 41,2	71,8
Interest rate subsidy of the state	197,4	33,2
State compensating credit losses	53,0	8,91

This stood against administrative expenditures of FmK 122,9 million (Euro million 20,5), real financing costs (interest expenses) of FmK 278,8 million (Euro million 46,9) and credit losses of FmK 132,7 million (Euro million 22).

To two different approaches are used to measure sustainability through lending activity:

a) **Spread-needed ratio:** The loss on bad debts in 1997 was FmK million 132,7 equal to 2.1% of the all outstanding loans and guarantees[25]. KERA's

[23] One Euro = 5,94573 FmK (figures are sometimes rounded)

[24] Income from interest was found on page 17 of the 1997annual report under "public and public sector entities" (unfortunately, there is a translation mistake according to our interview partners), income from fees under "commission income".

administrative expenditure was FmK million 122,9 (Euro million 20,5) equal to 1.9%. **This means that an interest spread of 4% between refinance costs would be needed to be self sustainable.**

b) Income against expenditure ratios:

Operational sustainability[26] (= 385,6+41,2/ 278,8+132,7 +122,9) = 80%

Financial sustainability[27] (= 385,6+41,2/ 278,8+132,7+122,9+ 85) = 69%

There are two important limitations on all that figures:

1. These calculations cover the whole of KERAs operations. If the degree of sustainability could be calculated for micro-loans and loans for women entrepreneurs alone the percentage of sustainability would be much lower, the interest spread would need to be much higher. According to KERA the larger loans in the loan portfolio are profitable. The borderline between small and unprofitable loans and the bigger and profitable loans is maybe around Euro 30,000. More detailed numbers for micros are not available at the moment.[28]

2. A precise figure of sustainability would only be measurable if loan officers' workloads were identified to client sizes. This is probably not possible and in a way would be not precise either because part of KERAs/ FINNVERAs efficiency is financing different sizes in SME and making use of synergies in different market segments.

Co-operation with formal banking sector

FINNVERA is one of the main players in the market for financing SMEs and micro-entrepreneurs in Finland.[29] The banking sector in Finland watches FINNVERA's operations carefully and will try to stop any move in a more commercial direction. FINNVERA 's precise market position is determined by a complicated political

[25] See annual report 1997, page 18, "claims on the public and public sector entities" of FMK 6303,6 million. However, it has to be kept in mind that this figure is not fully correct for our intention: we would need the average outstanding portfolio over the year and not the amount at the end of the financial year.

[26] calculated in the following way: Operational sustainability = income from clients /(re-financing costs + credit losses + administrative expenses)

[27] calculated in the following way: financial sustainability = income from clients /(re-financing costs + credit losses + administrative expenses + cost of own fund). Including the "cost of own fund" tries to inbound the opportunity cost for the equity capital of own capital. For our study we calculate this with an interest rate the double of the prime lending rate (in Finland this was near to 3,5% in February 1999). For the equity capital of Kera in 1997 FmK million 1,213 (page 19 annual report) this leads to costs of FmK 85 million. However, it has to be kept in mind that a more precise method to calculate opportunity cost would be the average ROE (return on equity) of similar operations, which is probably much higher then the double of the base rate. However, it could be argued that many banks on average make losses with their small firm lending business and therefore the average ROE could be also estimated on 0%.

[28] With the annual report of 1998 a more precise rate of sustainability of the micro-lending could be investigated by comparing the loan amount of lending to micros with the full size of expenditure enlarging income. However, this is still not very precise and lacking a realistic figure for bad debts due to the short term since programme implementation and the one year grace period.

[29] The other main players in the market for financing SMEs and micro-enterprise are: *Merita* bank - the dominate bank in Finland*, Leonia Bank* the postal bank and the small local banks, saving banks and co-op banks spread around the country.

process. To reduce the potential for conflict FINNVERA tries to avoid direct competition with the banks.

The major technique for co-operation could be described as "*steps of sharing risk*". According to our interview partner a typical client relationship career is as follows:

1. Micro/ start ups: For start ups with needs for small loans, FINNVERA is the entrepreneur’s only bank partner. It lends money for investment and for working capital.

2. Small business: For larger investments, FINNVERA co-operates with a commercial bank.

3. Medium size: In growing companies FINNVERA acts mainly as a collateral organiser.

This picture could be described as making a client bankable, introducing him to a commercial bank, sharing the risk while the business develops and then leaving the established business to use commercial banking alone. This can be seen as an active two-way referral strategy.

(A very good picture of that process is given on the KERA slide: "*The Steps of Growth of a Microenterprise*".)

According to FINNVERA the daily contact between the banks and the local branches is functioning very well, see also section "Client recruitment"

Non- financial service

FINNVERA does not provide many non-financial services. However, it is clear that part of the extra time FINNVERA spends on each micro-client in comparison with ordinary banks could be characterised as non-financial services and support.

Many of FINNVERA's loan officers work in small and isolated locations which gives them a unique understanding of the area’s market situation. It also raises some potential problems as to how to use this information when dealing with clients. According to FINNVERA's internal rules the loan officers must not help some clients more than others. The organisation has to be neutral in the local competition.

More directly, FINNVERA has developed a range of well known and used hand-books about: General management, Cash flow management, Marketing, Business planing. These books are available for Euro 80.

FINNVERA also carries out some of the necessary paperwork, a company needs once it is established and charge for this service. The amount and type of service the entrepreneurs can get and their prices varies between the branches.

FINNVERA works closely together with the "*State business service centres*", see also section "Client recruitment".

Benchmarking Case study

Fundusz Mikro, Warsaw Poland

Date of visit: October 26 to 28, 1998

Executed by: Jan Evers, Adriaan Loeft

Objectives and vision

Fundusz Mikro is a limited liability company which was established in Poland in December 1994. It is wholly owned by the Microfund Inc (MF), a not-for-profit organisation, established under the 1989 Support for East European Democracy Act (SEED Act), in the USA. The sole shareholder of Microfund Inc. is the Polish-American Enterprise Fund.

In one annual report[1] contains the following mission and vision statements:

Mission:

- to be the premier micro-lending institution in Poland
- to be one of the leading micro-lending institutions in the world
- to contribute to the advancement of the micro-lending industry

***Vision**:*

To offer loans, savings, other financial and non-financial services to Polish micro enterprises.

To facilitate the work of other micro-lending institutions in Poland as well as their client's enterprises by promoting changes to the legal, regulatory, tax and accounting environment.

To adapt existing foreign micro-lending methodologies for use in Poland; to develop new, innovative methodologies and practices which could be applied outside Poland; and, within practical limits, to make the benefits of our experience available for world-wide industry use.

The above quoted mission and vision statements, are complemented by more operationally oriented goals, aiming at short- and longer-term operational and financial sustainability. These are:

Goals:

To achieve annual operating and financial goals, e.g. numbers of active clients; repayment rates and financial self-sufficiency indices.

[1] Year ending 30 September 1997

To cover Fundusz Mikro's annual operating costs, including imputed costs of capital, with annual revenue from clients.

To be able to attract long-term borrowing as well as short term deposits from firstly, semi-commercial and, then, fully-commercial financial institutions.

Short history

FM started with just one expatriate initiator and no formal staff at all. The financier (The Polish American Enterprise Fund) had made a credit of USD 20 million available to initiate lending activities. The first FM management undertook a world wide survey of methods and techniques in all well known micro credit programmes and institutions. The most suitable and effective methods and concepts, together with four different lending methodologies, were then tested in 9 pilot projects during the first year of operations. The pilots were conducted with the lessons learned from each project, even those which failed, would become part of an ongoing, incremental process to devise a better system. The pilots ended in March 1996 and the current systems appear to be well-suited to Polish conditions and needs.

"Stepping into the micro-credit market in Poland was like stepping into a lake, not knowing how large it is, whether it is deep, or whether it can be frozen." (quote from CEO)

Organisational structure

Currently, Fundusz Mikro (FM) has 33 Branches spread over the whole of Poland, with a total stall of 63. In addition there are 7 Regional Managers, who oversee the operation of the branches. Lending activities are managed by the Loan Operations Director. There is also a Credit Manager. Together they form the front-office operation. In addition, FM has a marketing and PR department with its own manager.

The back-office operation consists of a Chief Financial Officer, supervising an accounting department with four staff and a chief accountant; a loan administration department with four staff, led by the Head of Loan Administration; a Personnel and Training Manager; an Information Systems Manager; an Office Manager; and one receptionist. FM is managed by a Chief Executive Officer. An internal auditor reports to the board. In total, FM employs in October 1998 94 staff.

FM makes use of only a few aspects of regular banking systems and operations:

- The organisational structure (front office, back office, credit management).
- Financial management systems.

- Credit risk assessment (by three assessors - “Citibank approach”; scoring system).

The market and the client profile

Clients are generally engaged in running small businesses, such as market stalls, retail outlets, taxis and private car hire, small construction and plumbing businesses, and repair services. FM only provides finance for existing business are financed, it does not support business start-ups.

FM defines there borrower profile as follows:

"Owner of a business

- registered at least 3 months previously
- employing fewer than 10 people
- profitable and in a positive cash flow situation
- not currently in debt and unable to access appropriate bank credit."[2]

Clients are 38% women, 62% men. The type of business is 54% trade, 35% services and 11% production.

Credit from FM generally provides working capital, mostly to purchase stock. Sometimes, however, loans are used for small investments in equipment, the replacement or upgrading of tools, or expansion of premises.

FM only advertised its services on a national level when it was first set up. Since then, word-of-mouth promotion has been the main basis for expansion of the client base. Branch managers do their own localised promotion. Advertising in newspapers is mainly used to demonstrate that it is an open service.

Facts and figures

FM is represented all over Poland. The first loan was disbursed in February 1995. The following table provides an overview of the scale of the operations of FM per 30.09.1998.

1.	Number of loans disbursed since inception	17.000
2.	Amount of loans disbursed since inception	USD 27.700.000
3.	Average loan amount	US$ 1.628

[2] presentation of Krzysztof Jaczewski to Round Table of Bankers and SME, Vienna, April 15, 1999

4.	Average loan term in months	8,44
5.	No of employees	94
6.	Total number of loans disbursed in 1998	10.700
7.	Amount of loans disbursed in 1998	US$ 19 million
8.	Loan balance outstanding for 1998	US$ 8.6 million
9.	Administrative expenditure for 1998	US$ 2.47 million
10.	Credit losses/Write off's for 1998	2,36%
11.	Delinquency rate for 1998	2,24%
11.	Income from clients in 1998	US$ 2.1 million
12.	Re-financing costs	0 %
13.	Estimated rate of survived enterprises (after three years)	Approx. 85%

Financial services and credit delivery methodology

Client recruitment

Client recruitment is done mainly on the basis of mouth to mouth in the business community. The strongest element is the self-interest of a potential borrower to find other borrowers to form a group but to select them carefully in order to avoid having to step in if they default.

Credit delivery methodology

Three starting principles form the basis of the lending methodology:

a) FM charges commercial interest rates

b) FM tries to overcome the widespread problem of lack of collateral by using personal guarantees of a group around the entrepreneur (either guarantors or other entrepreneurs in a credit group)

c) The borrower is assured access to follow-on loans if they repay on time.

Clients only qualify for a second loan if their first loan has been fully repaid exactly on schedule. Second loans can generally not be larger than 150% of the first loan.

Borrowers provide no business plan and give no official documents confirming their income. Their word is trusted (unless informal investigations prove them to be untrustworthy) and self assessment is a key part of the loan granting process.

The steps in the loan procedure are the following[3]:

a) First contact with borrower – by phone or in the office: examination on basis of formal criteria and informing the borrower about the further process and what to keep in mind for identifying further group members

b) Meeting with group of borrowers in the office: discussion of mutual obligations, examination of personal links between borrowers, examination of group risk factors

c) Individual meeting with group members: examination of their motivation and business skills, re-examination of links between group members

d) Visit the borrowers businesses: evaluation of their businesses

e) Analysis: evaluation of risk related to group aspects, borrowers motivations and business skills, viability of the businesses, stability of cash flow

f) Recommendation: joint proposal of two loan officers who had to contact borrowers

g) Approval: joint decision of two loan officers who recommend the loan and approving person who must not meet the borrowers but approves the way the risk was evaluated

h) Commitment: signing the loan agreement with all group members and co-signers

i) Disbursement: from FM's central bank account to borrowers' accounts or to the group co-ordinator's account

j) Repayment: bank transfer to FM's central account made by individual borrowers or jointly by the group co-ordinator

k) Monitoring: Visiting the borrower and/ or contacting by phone in order to maintain good relationships, discuss plans for the future and stimulate timely repayments

Cost and terms of services

The terms of the loans vary from 3 to 12 months.

[3] Round Table presentation, see above

Individual loans

An individual client has to provide three personal guarantors whose assets and income are also assessed. The interest rate for individual loans is 37%[4].

Group lending

73% of loans are provided to clients in groups. The interest rate for clients in a group is 29% or 30%.

Groups have at least four members, and generally consist of up to seven members. (Smaller groups have to present personal guarantors to complete the “group”. For example, two borrowing members must present two guarantors; three borrowing members have to present one guarantor).

The differentiation in interest rates between group and individual loans provides a “market mechanism”, encouraging clients to form groups.

Loan administration system

The time between the first visit of a group to a FM branch and the disbursement of the credit ranges from ten to fourteen days.

An LO (loan officer) spends, on average, about four hours per client or loan application during the appraisal process.

The credit operations manual is reviewed on an annual basis.

All loans are administered by a central unit inside FM's head office in Warsaw where three people are employed for the loan administration as to hand out loans, identify regular payment of instalments, inform branch managers on late payments and the loan documentation. All information on disbursed loans and payments made by clients are here typed into a computer database system (based on Excel, from spring 1999 transferred to an access system) provides the loan officers and the managers with information about the loan-portfolio and defaults rate and so on. A table summarising the most important indicators for each branch and for all of FM is send monthly to all branches to make sure that they are aware of the general and individual performance.

[4] Inflation stands at 8.5%, prime lending at commercial banks would be 24%, an overdraft facility would be 30%, inter-bank LOMBARD stands at 23.5%. Repayment and interest calculation is based on annuity repayment schedules, given equal payments per period.

Risk management

Credit worthiness assessment:

Two or three FM staff members are involved in the appraisal of loan applications.

Loans are approved by a three person credit committee. The LO (loan officer) visits the client and completes a two-page risk evaluation form (see annex 1). If it is deemed necessary after the forms are submitted, the Branch manager will also visit the client. The application is finally presented for approval to the Regional Manager (who is not known to the client) for the final decision. For loans of more than Z 20,000 the HQ Credit Operations Director provides a third perspective.

The credit worthiness criteria used in decision-making are:

(1) Motivation to repay

(2) Entrepreneurship / Entrepreneurial skills

(3) Business viability

(4) Cash flow coverage

For a first and small loan of, for example, Z 5000 the criteria are given a weighting factor of 40, 30, 20, and 10 respectively, in order of their relative importance. The weighting is adjusted according to the size and nature of the loan. For a second loan of Z 30,000, for example, the weighting is 10, 20, 30 and 40 respectively. The client is already known to FM, the requested amount is bigger, and the importance of cash-flow for debt servicing has increased.

For individual loans the co-borrowers are only accepted if they have a regular income which allows them to repay the loan if the borrower fails to do so.

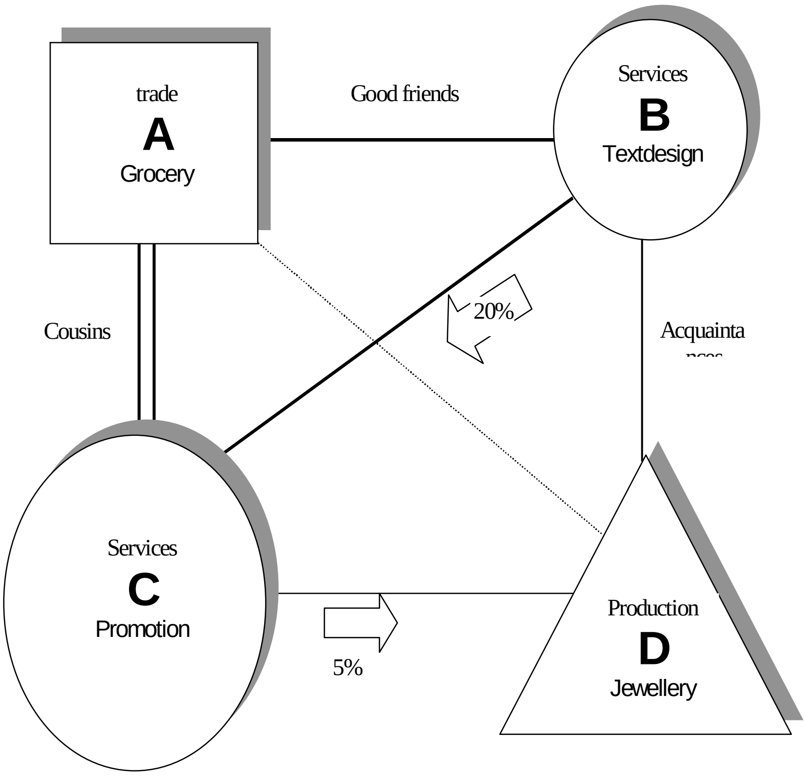
For group loans the factors determine the reliability of the group network are assessed: personal links, trade links, risk concentration and relative growth prospects. These factors are documented (very quick by hand) in a picture. See the following example:

- All members of the group are liable for debt servicing (joint and several liability)

- Clients form their own groups. The principles are explained to potential clients and group formation is left to the clients' initiative. Often family or existing business ties form the basis for the group.

- The linkages between the group members are depicted in a clear schematic drawing.

For each of the group members an individual scoring of the four credit worthiness criteria is undertaken (see above) – the results of borrower B can be seen in the graph below.



4.000 zl

40	30
30	25
20	18
10	8
100	**81**

Cash Flow-Quota: 53%

Ensuring payment and debt recovery

No physical collateral is accepted by FM because they believe it would weaken borrowers' sense of personal responsibility for repayment. The "motivation" to repay is assessed in-depth, through the character of the client (see previous paragraph).

FM aims at establishing a long term relation with the client, which provides security in itself.

The essential security is provided by the fact that only small loans are available in the first instance, and that new and larger loans can only be obtained if the previous loan is repaid fully and on schedule. Thus, the expectation of a new, larger loan is a form of security.

Peer pressure or "social collateral" applied through group members is essential. If one member of the group does not repay on schedule, follow-up loans will not be available to anyone in the group.

Other important risk management issues are:

- Transparency in all aspects of the process is a crucial policy of FM. The client should know all the procedures and, in particular, the philosophy behind the procedures. This affords the client shared responsibility for proper adherence to the rules and regulations.

- The loan size is always smaller than 200% of the existing assets in the enterprise.

- All borrowers have to sign a blank “wechsel”/ bill of exchange. This officially recognised document legally allows the holder (FM) to claim any amount from the borrower. This makes any court proceedings much easier, and also has a strong psychological effect.

However, if a payment is late the local loan officer will be informed by the central back office within 48 hours and the policy is to get in touch with the client straight away.

Covering losses

The strategy to cover losses is based on co-signers and co-borrowers who have been evaluated before approving the loan if they are financially strong enough to take over parts of the repayment responsibility. There is one exception: in the case that two group members fail, FM sees the responsibility within their own risk management ability and the remaining group members have to pay of only the first outstanding loan. This has happened only two or three times so far.

Loan administration and MIS

FM has developed its own loan administration system. This is based on the Microsoft Access database package. 17,000 loans (of which 8,300 are active) are administered. The system is based on fixed repayments in a schedule.

The system is simple and therefore easy to operate. On the other hand, however, the system has limited flexibility and is, therefore, not able to handle partial repayments, different interest calculation methods or new credit products. A new system, also based on MS Access, is under preparation which will be much more flexible and advanced.

There is no linkage to an accounting package. The system allows import and export of data into and out of the banking system.

Transaction reports from the banks (ING) are processed on a daily basis. At night, reports of overdue payments are faxed or emailed to the branches for follow-up action.

Sources of funding and operational and financial sustainability

FM has been financed from the beginning with a strong starting loan fund of US$ 20 million from the Polish-American Enterprise Fund and an additional fund with US$ 4 million for technical assistance was provided by USAID. Until today the total USAID was used to cover operational cost of building up the branch network and all pilot programmes.[5]

According to their plan, all FM's costs will have to be covered from operational income by April 1999. By November 1998 FM was covering 86% of its operational costs from lending operations revenue. Additional revenue (such as interest on cash balances) provides a net profit for FM. On this basis, financial break-even point (whereby operational income covers operational costs and market based financial costs) could be achieved in two years.

FM does not hold savings or deposits. This would require them to become a formal bank and would place it under central bank supervision. This would make it impossible to apply the micro-lending approach it currently uses.

FM is actively looking for new investors, since portfolio growth will require additional sources of funds in the near future.

FM is aiming for greater efficiency, increasing the number of loans per LO, which currently stands at 120 loans per LO.

Human resources

In October 1998 FM was employing 94 persons. Staff is recruited on the basis of criteria derived from the FM management principles of

- decentralisation, and
- individual accountability

Young graduates (from any educational background) are employed, who then complete full in-house training. (This consists of a one day introduction to FM and one month on-the-job training or twinning). A 3 months probation period is strictly applied.

Banking experience is a disadvantage rather than an advantage. FM's principle of credit delivery requires a different mind-set from commercial banking orientation. Knowledge or personal experience of the SME sector is a strong requirement.

The level of staff turn-over is reasonable - twenty people have left since FM began.

Lending Officers (LO's) are partly remunerated through a bonus system, based on quality and quantity of loans. In addition, supervising managers can, at their discretion, divide bonuses of up to 15% of salary budgets between staff.

Co-operation with formal Financial sector

FM does not handle cash. It has no counter or cashiers.

All transactions are done through the regular banking sector.

One bank is selected, on the basis of its network and advanced electronic banking facilities and data exchange options, as the main partner (Kredyt Bank PBI – Polish retailer bank).

Currently there is no policy in transferring grown up clients (maximum loan size is 30.000 Zl) to other banks – mainly because the banks represented in Poland are not interested in small firms.

Non-financial services, such as Business Advisory Services (BAS)

FM does not specifically provide non-financial services to its clients.

However, the LO spends a great deal of time with the client in the loan application phase (see risk management) and after the loan is disbursed. The LO visits clients who have active loans and, during these visits, provides limited business counselling.

The group process facilitates mutual assistance and advice among clients. However, the group process (e.g. number, timing and content of meetings) is left to the responsibility of the clients.

Benchmarking case-study

Glasgow Regeneration Fund, Scotland, U.K.

Glasgow, United Kingdom

Date of visit: February 18 to 19, 1999

Executed by Adriaan Loeff, Facet and Stefanie Jack, IFF

Objectives and vision

The overall objective of Glasgow Regeneration Fund (GRF) is 'to encourage and nurture profitable and sustainable enterprises in areas that are amongst the most depressed and disadvantaged in Glasgow, and arguably in the UK'[1]. That means that the Fund supports, stimulates and develops enterprise opportunities in disadvantaged local areas of Glasgow. It is based on an awareness that people in these areas may have the skills to build up their own business, but have no access to traditional sources of credit. The provision of loans and equity promotes the growth of businesses and jobs in these areas. GRF's objective is to contribute to the strengthening of sustainability in 8 local Regeneration communities.

Short history

"*The Glasgow Regeneration Fund was set up as a fund targeted at small business development projects in eight of the most disadvantaged areas of Glasgow – known as the Regeneration Areas. The initial concept was to create a bank similar to other initiatives in Europe. The idea was taken forward by the former Strathclyde Regional Council, Glasgow City Council, Glasgow Development Agency (GDA), and the Body Shop.*"[2]

As a result the Glasgow Regeneration Fund was launched working under the auspices of Developing Strathclyde Ltd (DSL) which was also established in 1993. The initial funders were the GDA, Strathclyde Regional Council, Glasgow District Council, Royal Bank of Scotland, Body Shop International, BP and Scottish Homes. A Company limited by Guarantee, the organisation has Enterprise Trust Status. "Developing Strathclyde Ltd ... embraces the

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[1] Taken from 'An Introduction to the Glasgow Regeneration Fund' 1994

[2] LEDIS, Updated Initiative A588, April 1998, page 1

philosophy that a strong local economy is the foundation of a healthy community."[3]

Under this ideological umbrella the organisation's purpose was to encourage and stimulate entrepreneurship and job creation in the regeneration areas of Glasgow by giving micro-credit, and on occasion small grants[4], to small enterprises and start ups. "Trade not aid" was the policy. The directors of Developing Strathclyde Ltd set a target of raising total funding of £3 million to be used for loan funding as well as for covering operational costs of the managing company (Developing Strathclyde Ltd.).

In the first three years (1993-1996) the funds raised were administered under contract by another enterprise trust called Glasgow Opportunities. The Glasgow Regeneration Fund did not operate an office in its first three years. In November 1996 a full-time Chief Executive was employed who oversaw the management of the Fund which, for the next 18 months, was still under contract to Glasgow Opportunities. The Chief Executive then started to build a small team, including a full time Fund Manager, to take the fund into a stable and balanced configuration.

Organisational structure

The Board of Directors of Developing Strathclyde Ltd. represent the founding organisations from 1993, although there has been some change in the individuals since that time. The board of directors is constituted by members of the Glasgow Development Agency, the Glasgow City Council, the Royal Bank of Scotland, Scottish Homes, Community Enterprise in Strathclyde (since January 1988) and representatives of private industry.

The Glasgow Regeneration Fund (GRF) has grown in size and activity beyond all expectations and remains the principal activity of Developing Strathclyde Ltd. Thus GRF is in charge of all loan disbursement activities, the administration connected with loan disbursement and fund raising. Furthermore GRF conducts thorough research on its current situation and future developments so it can set a strategic path for the future development of the fund.

GRF operates a Main Fund which is distributed to the eight regeneration areas in Glasgow - Glasgow North, East End, Govan, Gorbals, Drumchapel, Castlemilk, Greater Easterhouse and Greater Pollok. Alongside the main fund, a number of joint regeneration funds have been set up with the Local Economic Development Companies that are based in each of the areas.

[3] Developing Strathclyde Ltd; The Glasgow Regeneration Fund---A Foundation for the Future---A Briefing Note, page 1

[4] GRF no longer awards grants

Five of these eight LEDC's contribute some of their (usually public) funding to these joint funds. This money is matched by the same amount of money from GRF. The resulting joint fund is consequently used for local loan disbursement. The five LEDC's which have set up local joint funds are: Glasgow North Ltd, Greater Easterhouse Development Company, Drumchapel Opportunities, Gorbals Initiative and Castlemilk Economic Development Agency. The remaining three LEDC's (East End, Govan, and Greater Pollok) do not have their own funds and just receive funding from the main GRF fund.

GRF is currently investing a portion of the main fund in a number of special projects, one of which is the Glasgow Women's Microcredit Project. This program works with a group-lending scheme and is located in the East End of Glasgow. Capital and advisory assistance are contributed by GRF.

GRF's office is located in the centre of Glasgow (not in one of the eight regeneration areas) and employs a total of four people, augmented by private secto secondees, when available.

Human resources

GRF's office is located in the centre of Glasgow (not in one of the eight regeneration areas) and employs a total of four people, augmented by private secto secondees, when available.

The Chief Executive is the first person to mention. In addition, there are up to three fund managers (one directly employed Fund Development Manager and up to two seconded fund managers) who are responsible for managing the loan disbursement, loan administration and loan collection; one Research and Information Manager in charge of reporting on performance, developing new projects and overseeing the day to day running of the office; and one administrator who supports the Fund Managers, Chief Executive and Research and Information Manager.

As mentioned above two of the fund managers are seconded from the banking sector. None of the other staff members are recruited from the banking sector. The business advisers in the LEDC's, who are working with clients directly have extensive management experience from the private sector.

Members from the Board, Approval Panel and Advisory Group are recruited from public sector institutions (Glasgow City Council; Glasgow Development Agency) and from the private industry. These people are either appointed by their organisation or they are headhunted by GRF.

Target Group and client profile

The Glasgow Regeneration Fund supports small and medium-sized enterprises in the above mentioned eight regeneration areas of Glasgow. These areas are characterised by a high rate of unemployment and a very weak socio-economic structure. Support is spread at the micro level (socially directed investment) as well as to the macro level (socially responsible investment).

Approximately 50% of GRF’s clients are new business start ups, and 50% are existing businesses. The only trading status which is recognised are sole traders/ partnerships and ‘limited’ companies.

Facts and figures Main Fund plus the LEDC funds

1.	Number of loans disbursed since inception (as at 31/3/99)	227
2.	Amount of loans disbursed since inception	£ 1,918,741
3.	Average loan amount	£8,500
4.	Average loan term in months	24 to 60 months
5.	No of employees	4(6)
6.	Total number of loans disbursed in 1998/99	46
7.	Amount of loans disbursed in 1998/99 (April 1998 to March 1999)	£395,100
8.	Loan balance outstanding for 1998/99 (31.3.99)	£565,000
9.	Administrative expenditure for 1998/99	£175,000
10.	Credit losses/Write off’s for 1998/99	£80,000
11.	Delinquency rate for 1998	N/a
11.	Income from clients in 1998/99	£129,800
12.	Re-financing costs	0
13.	Estimated rate of survived enterprises (after three years)	44%

Financial services and credit delivery methodology

Client recruitment

GRF is known in the local community through articles about the fund’s activities in the local media. Furthermore they distribute leaflets through a number of community based organisations and advertise a freephone telephone number as part of the Business Shop network.

As almost all loan applications are currently channelled through Local Economic Development Enterprises the main client recruitment comes through business advisors working in these LEDCs. Information material and leaflets about GRF is placed in all eight LEDCs, in libraries and job centres.

GRF is currently in discussion with banks on the possibility of them referring clients who make unsuccessful loan applications to the banks. This system has not yet been implemented.

Current Products and plans for future products

GRF's main products are loans for existing small and medium-sized enterprises. The loans are typically small scale, between £1,000 and £30.000. Average loan size is £11,000. Loans are normally agreed to be paid back after a period of 2 to 5 years.

GRF also funds equity and sometimes issues bank guarantees for overdraft facilities for their clients. The fund has also been issuing grants to selected companies, although they are trying to phase out these grants. To date, GRF has disbursed 88% loans, 9% grants and 3% equity.

GRF is currently in the process of setting up pilot projects specialising in providing microcredit to individuals attempting to set up a business. These loans are managed as group loans, where each member of the "*business credit group*" vouches for each other. These small loans are available to small existing companies as well as start up's. The exact procedure of the loan disbursement and credit collection for these "*business credit groups*" is still at a pilot stage, hence has not been described here.

As part of the Glasgow Women's Microcredit Project, the Glasgow Regeneration Fund helps women who need reasonable small cash loans to set up their own business. The project is based at the Wellpark Enterprise Centre.

Wellpark Enterprise Centre was established to provide a centre of support and assistance to women's enterprise and business development. The Women's Microcredit project aims to provide an alternative means for women to gain access to small business loans. It also wants to raise the income of women in Glasgow.

To achieve these goals the Wellpark Enterprise Centre offers additional sources of (grant) funding to those who meet specific programmes' criteria, and also offers other services like:

⇒ Training in business skills
⇒ Giving information and advice to women starting a business
⇒ Help with creative business ideas and their generation and evaluation
⇒ Giving practical on-site assistance
⇒ Organise networking events for business women

⇒ Organising marketing and PR events for women in business

The group lending microcredit project offers very small loans, of between £200 and £3,000, and thus differs in size from GRF's conventional loan product. In addition, the provision of assistance and training targeted at women thinking of setting up in business is new in Scotland.

GRF is also considering a project to provide microcredit in co-operation with the "Big Issue" initiative. This initiative helps unemployed and homeless people to earn some money by selling the magazine "Big Issue". Once they have found accommodation and thus can no longer sell the magazine, GRF plans to offer those former vendors who would like to go into self-employment the opportunity to obtain small business loans. This idea however is not yet fully developed and hence is not included in this report.

GRF is also building up a track record in socio-economic analysis and reporting. They receive information from a wide variety of sources and collates the information for interested parties. In particular, GRF is building up an expertise on 'access to capital' issues in Scotland. "*GRF is providing intelligence*".[5]

Last but not least GRF is seeking to expand the microcredit approach beyond the borders of Glasgow. They would like to set up a partnership or joint venture approach with other city councils in order to establish a "pan-Scotland" fund.

Credit delivery methodology

Applications for loans are channelled through the Local Economic Development Companies. The LEDCs are specialised in giving people advice in how to set up their business, advice on developing their businesses and help with a number of other business related services. The business advisers in the LEDCs can help with drafting a cash-flow and a business plan and give advice in management and marketing issues.

Once the client expresses the need for a small loan the local business adviser will help him to complete the loan application form and will write a report on the business structure. The loan application must be accompanied by the following information:

⇒ Number of employees living in the regeneration areas
⇒ Details of existing employment
⇒ Forecast of future employment
⇒ Credit check

[5] Quote of David Brown, GRF Chief Executive

⇒ Copies of correspondence with other lenders approached
⇒ C.V.' of all applicants
⇒ Personal and financial profiles of all clients partners or directors of the applying company
⇒ Details of the full funding package being sought
⇒ Details of available security and security being given to other lenders
⇒ Details of proposed expenditure
⇒ Detailed business plan and financial projections incorporating two years cash flow
⇒ At commencement of the contract the company is requested to set a management account reporting system in place
⇒ All directors loans to be injected and in place as share capital prior to loan/grant agreement
⇒ Documentary evidence of other lending sources

For applications to the main fund, the GRF Fund Manager presents the application to the main approvals panel. The application is presented with both the Fund Manager and LEDC advisor's recommendation. The local joint funds vary slightly from the main fund, and also from each other as each local fund has been set up according to local need and circumstance, the approvals procedure of each may vary. Applications to the local joint funds may be presented by the LEDC business advisor or by the client him/herself (or by both).

The loan maximum for each of the funds varies from fund to fund, and whether the client or business advisor presents the application also varies. In all joint fund cases, the GRF Fund Manager can vote but does not usually exercise that vote unless there is a split decision amongst panel members. Across all the funds (including the Main Fund), should the client be turned down he may apply again. (No fixed time scale). Clients are rarely refused funding outright, but applications may be deferred pending more information required, or criteria met. Prior to presenting the case to the local approvals panel, the business adviser will meet with the client in their own premises in order to get a better understanding of the business.

If the loan applied for is higher than the maximum of the local joint funds, the LEDC business adviser submits the application to the Fund Manager at GRF's office. The Fund Manager visits the business (often with the business advisor), checks the application form with all appended material, writes a short report on the client's situation and presents the application with his 'recommendation' to the main panel. The main panel constitutes members of the Glasgow Development Agency, Glasgow City Council, Royal Bank of Scotland, business people and accounting experts from private industry. Members of the main panel are a mixture of representatives from the public and private sector.

The main panel meets approximately 10 times a year. Usually the decision about whether the client will receive a loan will be made on the day of presentation. In 90% of all presented cases the main panel will accept the fund manager's recommendation. Fund Managers are not allowed, however, to present a loan application made directly to him, to the main panel. He may only present applications channelled through business advisers at LEDC's.

If the loan applied for is higher than £20.000 the application has to be approved by the board of directors.[6]

Cost of services

The interest rates charged by GRF are between 2% and 3% higher than the prevailing bank base rate. The normal bank interest rate in Scotland is between 4% and 15% higher than the base rate. This means that GRF provides much cheaper loans than banks. GRF usually does not charge any fees for their services. Charges are only made if legal services are involved.

Loan administration and MIS

All loans are administered centrally at GRF Head Office for all eight LEDC's.

Money is transferred to GRF's bank account by the client once a month via standing order. The dates for payments are currently the 2nd and 20th of each month.

At the GRF office all payments are recorded on a loan database set. However, as this system is quite old and does not comply with recent requirements a new system is currently being tested and implemented, which uses File Maker Pro. This system collects and provides more management and statistical information than the one currently in use. The new system is custom-designed by an IT consultant, overseen by the fund manager of GRF and means that dates for repayment are not set for the 2nd and the 20th of each month but can be more flexible, according to the day of the month when the loan was disbursed. For safety reasons, both computer systems will be used parallel for some time.

Each GRF client has a bank account. GRF receives bank statements twice a month. Five days after payments are due GRF receives the bank statements and is able to monitor it's overdue accounts.

Risk management

As mentioned above there are three levels of risk assessment in the credit approval process: Loan applications higher than £20,000 need the approval of the board of directors. Loan applications between the maximum of the local joint fund and £20,000 need the approval of the main panel. For loan

[6] Constitution of board of directors see chapter 1.3. Organisational Structure

applications between £1,000 and that maximum the risk assessment and loan approval is devolved to the local approval panel.

The new group-lending product should be mentioned here, which is a fourth level of credit approval. Microcredit is disbursed (an amount between £500 to £2.000) and will devolve the loan decision to the peer group itself. However, this project of microcredit for peer groups is in the process of being set up and hence will not be the subject of this study.

The following core criteria for loan disbursement are defined:[7]

*	Geographic	⇒ The actual physical location or base of activity must be within the area boundaries of the specified regeneration/priority area (s)
*	Commercial	⇒ The application, enterprise or organisation must intend for their activities to be commercially viable (E.g.) for-profit whether for the benefit of the company or the local community.
*	Sectoral	⇒ Applications from manufacturing and service sector(s) enterprises are sought and encouraged. Funding is not available for retail business.
*	Viability	⇒ The application must establish, and provide evidence of, the viability, sustainability and prospects for medium/long term growth (sales, profit etc.).
*	Local Impact	⇒ The impact of the proposal on socio-economic grounds will be a key component (e.g. existing business expansion, new business creation, local job creation/retention, stock from local suppliers)

Ensuring payment

If the applicant is not an experienced business person, GRF and the LEDC's try to ensure that he has received proper business and management training in cash-flow planning and business-planning prior to receiving the loan.

Once the loan agreement is signed and the cheque for the client is issued, it's the business adviser's responsibility to look after the client. GRF's approach is to ensure payment via good and careful client after-care. The business adviser receives a monthly payment report from the fund and after-care manager. With this material he is asked to visit the client approximately every three months, the first visit being after 6 weeks. Every three months the business adviser is

[7] Developing Strathclyde Limited, GRF/LEDC Local Regeneration Funds Operating Manual

supposed to write a short report on the client's business. These reports, however. take quite some time and very often the advisers are not able to present them on time. That means that the fund manager sometimes only receives these reports on a six monthly basis.

GRF does not charge any penalty to the client for delayed payment. However through the banking system the bank charges a £25 penalty to the client if a standing order is assigned without the necessary capital being available on the client's account.

Should one instalment not be paid, the client will be telephoned by GRF and contacted by the business adviser about 14 days after payment was due. In case two instalments are missing the client will be visited by the business adviser and on a case-by-case basis by the fund aftercare manager. Debt collection letters are sent out if this seems necessary. However GRF does not have any standard letters for these purposes. A standardised and obligatory debt collection procedure is not set up by GRF. The procedure is determined on a case-by-case basis.

Covering losses (Collateral or security)

GRF/LEDC operating manual asks for security from the clients and in the case of a small enterprise it asks for personal guarantees and for bigger companies other appropriate security (like business property) is asked for.

However in fact GRF is very reluctant to ask for collateral or security from the client. It is GRF's policy that it does not call up the security given unless fraud is suspected. Should a sole trader for example prove to have been doing his best and still not able to pay back his loan, GRF will write the loan off. During the entire period of disbursement of 216 loans, security has been successfully collected in only three cases.

Debt recovery

As mentioned above the business adviser will visit the client 6 weeks after loan disbursement in order to check how the business is developing. A monitoring report about client's business is supposed to be written on a quarterly basis for the fund managers at GRF to keep an eye on the loans.

If a client is honest about his business problems and is able to explain his repayment problems it is very likely that GRF will give a capital holiday of three to six months. In this case neither interest nor capital is collected. The other option is to re-schedule the existing agreement. A new repayment plan will be agreed upon. Should letters be ignored and visits be useless legal action will be taken. However, according to GRF staff, this is very seldom the case.

Sources of funding and operational financial sustainability (including transaction costs)

The following organisations and companies have contributed to GRF's main fund, which adds up to over £3 million:

European Union European Regional development Fund (ERDF), Glasgow Development Agency, Whyte & Mackay, Glasgow City Council, former Glasgow District Council, former Strathclyde Regional Council, Atlas Investment, Glasgow North LTD, Grater Easterhouse Development, Drumchapel Opportunities, Combined Property LTD, The Body Shop, Scottish Homes, Royal Bank of Scotland, British Petroleum.

There is currently no information available as to percentage of contribution from the respective organisations.

From the total fund of £3 million GRF has invested £1,918,741 to end of March 1999. 88% of this money is invested in loans, 9% in grants and 3% in equity. The annual operational costs were £175,000 in 1998/99. The total fund invested in loans over the same time period was £395,100.

Looking at GRF's investment and fund balance, the total loan capital disbursed plus the operational cost plus the write-off's, in relation to the money incoming from interest rates and loan collection, there is evidence that GRF is loosing £200,000 per year. Hence loan capital is reducing and the fund itself will not be able to survive unless further grants and funds from the public or private sector will come in.

Co-operation with formal financial sector

The co-operation with the banking sector is established through financial support and in-kind support. From the Royal Bank of Scotland GRF received about £25,000 and banks have provided secondees to work for GRF in loan administration and collection. One Fund/Aftercare Manager is seconded from Bank of Scotland and one Fund Manager has been seconded from the Clydesdayle Bank.

The bank's motivation to provide secondees is to learn to understand the economic "enterprise network" in Glasgow and Scotland in order learn more about the needs of 'micro' clients and to build up a good network of enterprise contacts. Furthermore, they want to contribute, through better client support, to the future development of their customer base. "*To help GRF is one way for the banks to reach very small enterprises and to contribute back into the local community*"[8].

[8] Quote Anthony Dorrington, Fund Development Manager

This support however is not guaranteed for further years to come. In fact both employees will stay only with GRF for the coming two months.

Banks also provide members for the Board, the approval panels and the advisory group.

Benchmarking case-study

Industrial Common Ownership Finance (ICOF)

Birmingham, United Kingdom

Date of visit: February 19, 1999

Executed by Stefanie Jack, IFF and Adriaan Loeff, FACET BV

Objectives and vision

ICOF seeks a commitment to equal opportunity; social justice; environmental concern and ethical business. Recognising that ”people are the business”, means that ICOF is prepared to increase its exposure to risk in order to provide opportunities that the mainstream financial institutions might reject.

Industrial Common Ownership Finance (ICOF) provides loans throughout mainland UK to co-operatives and businesses operating in the social economy.

> *The primary purpose of ICOF’s Funds is to encourage local economic regeneration by enabling local people to create, own and democratically control the business in which they work, or which operates in their local community.*

All types of social economy businesses are able to apply to ICOF, including co-operatives, community businesses, green businesses and businesses developed from the voluntary sector. The notion co-operative is very loosely defined.

ICOF provides financial services to those enterprises which practice or support the principles of co-operation; common ownership; employee, community or social ownership; workplace democracy and sustainable development.

The Social Economy comprises businesses which variously call themselves co-operatives, community businesses, voluntary sector businesses and social or green businesses.

Short history

ICOF started its lending operations in 1973. It was originally initiated as the **I**ndustrial **C**ommon **O**wnership **M**ovement (ICOM). The movement was established to represent the “new” worker co-operative sector.

Between 1973 and 1976 capital was raised from individuals and supportive companies, notably Scott Bader a democratically owned chemicals company who provided a facility of £100k. It started very small. Providing loans of £200 to £500. In 1976 ICOF was recognised as the appropriate national body for co-operative financing when the Industrial Common Ownership Act was passed through parliament.

Until 1979 ICOF employed two staff members. In 1985 ICOF employed 2 lending officers and a general manager.

Between 1976 and 1985 ICOF managed to obtain fund management contracts from many local authorities (Local community Development Agencies, Enterprise Development Funds). Local authorities were coming under stronger central control and looked to ICOF to put control of their funds with a third party.

Presently the ICOF group employs three full time staff members, all active in lending operations, and one of them responsible for general management.

Total assets of ICOF amount to approximately pnd 2.5 million.

Organisational structure

The ICO Movement (ICOM) is represented in ICOF through two seats on the board of ICOF Ltd.

The ICOF Group is governed by a Board of trustees, consisting of 10 trustees. The Group consists of **ICOF Ltd** (Limited by guarantee). ICOF Ltd has about 150 members This entity serves as a holding company. ICOF Ltd manages a number of funds for local authorities and provides all the back office services for these funds. The total resources amount to approximately £1,000,000. ICOF Ltd employs all staff and has the IMRO licence[1].

ICOF Ltd wholly owns a public share company, **ICO fund Plc**. ICOF Plc was established to raise additional funds through share issues. The shares are redeemable preference shares. The total resources mobilised by plc are approximately £1,000,000. Minimum investment is £250.

In 1994 **ICOF Community Capital Ltd** (ICC) was established. ICC is a society for the benefit of the community and although under the ICOF brand is a separate and independent organisation. ICC is managed by ICOF under the terms of a service level agreement. The purpose of Community Capital is to open up the possibility of lending to other clients (individuals and development trusts) than only co-operative or common ownership based businesses. Community Capital also lends to general community businesses, Local Enterprise Development Companies and social enterprises. Community Capital has raised approximately £500,000, through some 400 members, each investing about £1250. Another £500,000 is expected.

ICOF limited has also established **ICOF Guarantee Company Limited**. The purpose of the guarantee company is to establish a fund in which waived

1 IMRO is a self regulatory organisation, and has been established under the Finance Services Act. IMRO supervision is needed if one manages funds of others.

dividends and interest payments are accumulated. Investors indicate in their contract what they want to do with their dividends. The fund then serves as a provision for any loan losses made on the ICOF Community Capital loans.

ICOF operations are under the control of the Investment Managers Regulatory Organisation (IMRO). ICOF Ltd holds the IMRO licence.

Staffing

Presently ICOF has two full time lenders as staff. One located in Cambridge, the other one in south Wales. The general manager is based at the head office of the ICOF group in Birmingham. He supervises the lenders operations (appraisal reports) and takes final decisions on credit approval. All administration of ICOF is done centrally by the general manager. In addition, from a few months ago, a part time administrative assistant is employed in Birmingham.

Target group and client profile

ICOF is in the business of ”social investment”. Its mission is to provide access to finance for categories of people (businesses) that otherwise would not have access to finance.

This is the starting point. When such a client is identified, THEN financing is provided on a sound, transparent and business-like basis, where, if needed, legal action is also taken against clients.

Borrowers must be engaged in an income-generating activity, where a sufficiently strong cash flow is generated.

To be eligible for the different sources of funding they must be either organised in a common ownership structure, or be a community-based enterprise, active in the social economy.

The definition of a co-operative is rather general:

- 51% ownership of voting equity by members of co-operatives
- free and open membership
- equal voting rights
- more than 50% of workforce are members
- having a dissolution clause
- operating a viable business

ICOF is also, on a limited scale (10 to 15% of its portfolio), involved in so called ”bricks and mortar” loans (mortgages). It does only ”gap funding”, providing the last remaining 30% of funding. Term is generally 10 to 15 years. This loan category also serves as a buffer to spread risk in the total portfolio.

Facts and figures

1.	Number of loans disbursed since inception	500
2.	Amount of loans disbursed since inception	£ 5.000.000
3.	Average loan amount	£10.000
4.	Average loan term in months	6 months to 10 years
5.	No of employees	Under 5
6.	Total number of loans disbursed in 1998	52
7.	Amount of loans disbursed in 1998	£500.000
8.	Loan balance outstanding for 1998	£925.000
9.	Administrative expenditure for 1998	£160.000
10.	Credit losses/Write off's for 1998	£29.000
11.	Delinquency rate for 1998	3%
11.	Income from clients in 1998	£104.251
12.	Re-financing costs	-
13.	Estimated rate of survived enterprises (after three years)	90%

Financial services and credit delivery model

Client recruitment

Promotion has not always been done in a very structured way. Recently a more pro-active attitude was adopted. Promotion is done throughout mainland UK. Word of mouth is one of the most important sources of new clients.

ICOF often uses inserts (flyers) in magazines that target potential client or investor segments, to promote its activities. Approximately 25% of clients that approach ICOF do not obtain a loan. They are either discouraged from going ahead, or withdraw themselves. Approximately 90% of clients who actually make a formal application will receive funds.

Current products and plans for future products

Loans are minimum £1000 (although actually below £5000 no profit is made) and have a maximum of £50.000.

Interest rates are 1) variable rate is base + 4%

2) fixed rates are 9 to 12.5%

Presently base rate stands at 5.5%. The average rate charged is around 11%. The rates charged by ICOF are very much in line with commercial mainstream lending.

The terms for the loans can vary from very short bridging loans, to 15 year investment loans, with a bullet repayment after 10 years.

A declining (annuity) system is used to prepare repayment schedules. The MIS system automatically calculates the repayment schedule.

In the future, ICOF intends to become a service provider for Social Investment Funds. It will design such funds, provide management advice and back-office administration systems. A manual has already been prepared to do this.

Credit delivery method

The turn around time for approving a loan can be as short as 6 days. Once the loan agreement has been signed, the credit is transferred to the client bank account.

The system is very basic and straight forward. There are not many present formats and requirements to follow. It is very much up to the personal assessment of the credit officer to decide about the credit worthiness of the client (see also paragraph 1.8)

Cost of services

On each loan, a fee is levied of, target, 1.5 %. However, this fee is applied in a flexible manner, depending on the actual effort it has taken to do the appraisal and processing of the particular loan. The fee is subtracted from the loan disbursement, and an invoice is issued.

In addition (additional cost item) the borrower must become a member of ICOF, at an annual membership fee of £8 per year, or alternatively, the borrower must become an investor member of the community capital society at a minimum of £250 which is redeemable.

Loan administration and MIS

The ICOF group has developed its own professional and advanced loan tracking and fund management system. It uses EQUINOX 2 database application software, developed by Compsoft. The financial administration system also handles the funding side of ICOF operations, tracking individual accounts of investors, producing share certificates, and share account statements.

In addition, for its accounting, ICOF uses the SAGE accounting software.

Data from the MIS database are ”exported” to SAGE through reports generated by the database. There is no direct linkage between the two packages.

Since the system is based on a database, all kind of reports on individual loans and total loan portfolio can be generated. Missed payments are signalled by the system after two days of their occurrence.

Risk management

Credit worthiness assessment

Clients are made aware of ICOF services through brochures, that include a simple loan application form. The application forms require preliminary information about the business to be financed and the persons involved and employed, especially ethnical background. The applicant also provides authority to ICOF to make credit reference enquiries and any other enquiries. The form has to be submitted with a written proposal. There is no formal format for proposals/business plans, but formats are suggested in an explanatory booklet. Business plans are generally not more than a few pages. Cash flow projections are made.

All serious applications are visited by a lending officer, for an average of half a day.

The lending officer prepares an appraisal report, which is submitted to the general manager, with a recommendation. ICOF recognises that appraisal always has a subjective element. It is essential that the judgement of the lending officer is finally justified by the results.

After credit is granted, clients have to submit management accounts every quarter to ICOF.

As mentioned before, there are no precisely defined criteria for the credit approval decision. This is left very much to the judgement of the lending officer.

Ensuring payment

Repayments are made by direct debit from clients’ bank accounts, giving ICOF the right to withdraw the payment from the clients bank account. If a payment is missed, within 2 days a warning is issued. Then mostly payments are still made but by cheque.

Payments are typically scheduled for the 18th of each month. Late payments are quite strictly followed-up by ICOF. In most cases payments are made after warnings are issued. If needed, legal action is taken.

Covering losses

It is a policy of ICOF not to take personal guarantees because it does not want to force individuals into bankruptcy, or have them removed from their houses. Otherwise, any security that is available is taken. There is no minimum percentage set for securities. Often loans are not secured. Recently assets have been taken as collateral (chattel mortgage).

ICOF Guarantee has been established as a fund into which waived dividends and interests from ICC shareholders are accumulated. This whole fund underwrites all losses in the ICC. Using this fund also has tax advantages, by allocating it to the unit where losses are made.

The specific funds managed by ICOF Ltd take all losses made on the loans. Any revenues generated, can be accrued to ICOF.

Debt recovery

As mentioned, payments are collected by direct debit. If clients have repayment problems, solutions are sought by suspending capital repayments for a certain period (capital holiday). Otherwise the loan can be fully rescheduled by closing the existing loan and opening a new loan with a new repayment schedule. In the ultimate case, legal action is taken, the business is closed and assets liquidated.

Rescheduling of loans is done whenever felt applicable, and is therefore used as a normal instrument to create a work-out solution.

Sources of funding and operational financial sustainability

As mentioned before, the ICOF group actually consists of different entities, that have been established to serve as vehicles to raise funds, and to serve specific segments of the client target group.

ICOF Ltd.:

Source of funds is mostly the capital it has in custody from local development authorities, and which it has to manage on behalf of those authorities.

Total amount stands at approximately £1,000,000.

ICOF Plc (owned by ICOF Ltd):

Plc has issued shares to the public. The total investment stands at approximately £1,000,000, held by some 1000 shareholders.

IOCF Community Capital Society:

Establishes its capital through membership shares. Minimum share is £250. Average holdings are £1250 per member. Total amount in the fund is approximately £500.000, held by 400 members/investors. An additional pnd £500.000 is expected to be invested.

ICOF does not fully cover its operational costs. Income from earning assets with clients covers about 50% of operational costs and all loan losses. More efficient operational methods are needed. Its wide geographical scope (mainland UK) raises costs of operations.

ICOF generally monitors its efficiency of operations through cost per pound lent, which stands at a rather high level of 0.32.

Financial projections are made on a yearly basis, for three years in advance.

Co-operation with formal financial sector

There is no structural co-operation with the formal banking sector, apart from making use of the common banking services, such as direct debits, and account statements.

Occasionally, joint-lending is done, especially for the so called ”bricks and mortar” loans.

Non-financial services such as Business Advisory Services (BAS)

In the early stages of contacts with potential clients, limited advice is provided in preparing a business plan, through dialogue with the client. They aim for a financial partnership. Through this relationship ICOF often becomes the "preferred creditor”.

After a credit has been granted business counselling is only done on an ad hoc basis, and at the request of the client. Regular visits are made, but they are not very frequent.

Future orientation is that ICOF increases non-financial services but for intermediate organisations rather then direct to entrepreneurs. It aims to become a service organisation for the social economy, working through local authorities. One of the main services it will offer is the organisation of all back office services for other fund raising and financing organisations.

Benchmarking case-study

Women World Banking, Spain

Madrid, Spain

Date of visit:

Executed by Claire Whyley, PFRC and Jan Evers, IFF

Objectives and vision

Women World Banking in Spain has three main objectives, these are to:

- help women into business
- help women negotiate with banks and gain access to favourable credit services
- change attitudes to women within the banking culture in Spain.

Short history

WWB was founded in 1989 by Inger Berggren. The original idea was to bring the international network of Women World Banking into Spain. The basis of Women World Banking is that an international collateral network provides 50% collateral for women to start-up a business, while the national branch provides a further 25% and a co-operating bank provide the remaining 25%.

However, this framework was not appropriate in Spain as there were no resources to provide the 25% collateral at the national level, as the policy of the head office changed and because issuing credit in Spain can only take place within the legal framework of a formal bank. Consequently, WWB Spain developed a different system. They negotiated with Caja Madrid, one of the largest saving banks in Spain, who agreed to provide loans for women referred from WWB.

WWB, therefore, works as an intermediary to raise the quality of start up and growth projects for the bank and also helps women, who are not generally viewed as potential entrepreneurs within traditional banking culture, to gain access to credit. However, WWB can only help women obtain loans if they meet one essential criteria – they have to have access to the necessary collateral to support their loan. This generally takes the form of a partner’s salary or their property.

Once the co-operation between WWB and Caja Madrid had proved successful, the arrangement was extended to five further bank partners. In addition, in 1991

WWB Spain returned to the lending model used by WWB International to try and overcome the exclusion of women without collateral. They developed a package whereby loans would be guaranteed jointly by WWB in New York and Caja Madrid so that women could gain access to credit without providing their own guarantees. In reality, however, the process of making loans in this way proved too time-consuming, taking several months to put the files together and get all sides to agree. As a result, WWB and Caja Madrid decided to abandon that model and, instead, now deliver some loans without any collateral at all.

In 1998 the Ministry of Labour in Spain agreed to finance *Credit Solidiare* - a group-lending model organised by WWB Spain. The Ministry provides 1 million Pesetas (XY Euro) per woman for groups of up to five women. Although this was a very positive step it was, to a degree, quite problematic. First, because the Ministry refused to provide WWB Spain with any capital to cover their transaction costs. Consequently, the scheme can only be run at a loss to WWB Spain. In addition, the Ministry was only prepared to provide funding for initiatives operating in rural areas. As a result the scheme was first introduced in Guadalajara, where demand was very low and were WWB Spain did not have a local infrastructure. Due to the absence of interested clients the group-lending scheme began with only 3 groups and did not conform to the traditional model. In effect, loans were made to individuals who were then organised into groups retrospectively. The women did not, in fact, know each other in advance of the scheme.

In 1999, however, WWB Spain plans to introduce the group-lending model to Segovia where they already have a local office and network, have secured funding to cover transaction costs, have been able to promote the scheme more widely and also have a co-operating bank which has agreed to leverage the deposit 1:2 into credit capital.

Organisational structure

WWB is represented in four cities in Spain and is affiliated with the international WWB organisation, which has its head office in New York and networks in fifty countries worldwide. WWB Spain is a private foundation headed by a President who leads a Board of Directors. The organisation has 23 employees in total. Seven are loan officers (LOs) and each office has two secretarial/administrative staff. The remaining staff work in WWB's four Trade Houses.

Market and client profile

WWB has two main markets, first, its lending activities, and second, its sales and promotional work.

WWB has four Trade Houses in Segovia; Madrid and Malaga. The Trade Houses operate as workers' co-operatives, each shop sells crafts and produce made by women from all over Spain. WWB receives 10% commission on these sales. The annual WWB Trade Fair also gives women a chance to sell the goods they produce. Each year, around 40,000-50,000 thousand people attend the week-long Trade Fair, held in Madrid. The event is sponsored by a consortium of private companies and by public grants (regional, national and European).

While many of the women who are involved with WWB's sales and promotional work are at a very early stage of their entrepreneurial career, the organisation's lending activities target a more advanced client group. WWB arranges finance for women to start-up new businesses and also provides working capital for women running existing businesses. Finance is available in the form of a loan – via five Spanish banks – or public grants.

To gain access to loans, clients have to provide collateral, a detailed business plan with a viable business concept and, crucially, have the self-confidence to promote it to the bank's loan officer[1]. WWB's clients come from a number of groups: young women who have recently completed a university education; women who have trained in a particular business or trade and have worked as employees for several years; and middle aged women returning to the labour market after caring for a family.

According to one of the loan officers, most of the women who are clients of WWB Spain would probably be able to gain access to credit without help. However, they prefer to apply to banks via WWB because they have a higher chance of success and also because these loans carry more favourable terms.

Facts and figures

1.	Number of loans disbursed[*] (in co-operation with bank partners) since inception	470[2]
2.	Amount of loans disbursed* since inception	1,54 billion pts
3.	Average loan amount	3,3 mill pts
4.	Average loan term in months	60
5.	No of employees	
6.	Total number of loans disbursed* (in co-operation with bank partners) in 1998	21
7.	Amount of loans disbursed* in 1998	110.300.000 pts
8.	Loan balance outstanding* for 1998 (31.10.98)	------------
9.	Administrative expenditure for 1998	210.000
10.	Credit losses/Write off's for 1998	2%
11.	Delinquency rate for 1998	0%
11.	Income from clients in 1998	0

[1] According to the loan officer Mercedes XY, interviewed at 19.01.1999
[*] WWB Spain does disburse loans only in co-operation with bank partners. See description above. Therefore there are no refinancing costs and there is no outstanding loan balance
[2] In 1996, 64, in 1997 26, and in 1998 21

12.	Re-financing costs*	-----------
13.	Estimated rate of survived enterprises (after three years)	50-60%[3]
14.	Number of enterprises started with the assistance of WWB	1853

Financial services and credit delivery methodology

With the exception of the new *Credit Solidaire* scheme, WWB do not deliver financial services themselves as Spanish law restricts these activities to formal banks. WWB Spain's role, therefore, is as an intermediary between the banks and their clients. They aim to make women more confident, effective and, ultimately, successful in their dealings with banks, of which most have very limited, if any, experience. WWB are also working to change the banks' attitudes to women customers.

WWB's main credit scheme involves helping women to apply for loans from the five banks with whom they have agreements. During their most busy period – March-May – WWB receives enquiries about this service from 200-300 women per month. They are given information about starting and running a business, about applying for a loan and, crucially, the need for collateral, without which WWB cannot help them. For those who are serious about setting up a business, are not put off by the prospect of applying to a bank and have access to collateral, the next stage is to decide which bank to apply to and attend an interview with the bank's loan officer. Often the WWB loan officer will recommend a particular bank, branch or even member of staff for clients to see, because WWB has a particularly good relationship with them and this significantly improves the likelihood of success.

If the outcome of this initial interview with the bank is positive, clients are asked to produce a formal business plan which they do in conjunction with WWB. The business plan must provide a detailed account of the business the applicant intends to set-up or is already running; a cash-flow forecast; an assessment of costs and a suggested repayment schedule. WWB loan officers provide extensive support at this stage of the process, often creating the business plan themselves on the basis of factual information supplied by clients. They also provide a letter of membership, confirming the relationship between the client and WWB.

Loan officers estimate that approximately 40-50% of people who are initially referred to a bank by WWB and who meet the bank's conditions return for assistance with constructing a business plan. Of those who submit a business plan to the bank approximately 90-95% are successful. WWB could not provide figures or estimates of the number of clients who are sent to bank partners. However, on the basis that there are three busy month each year with 200 initial

[3] According to the loan officer Mercedes. Very interesting is the comparison with the survival rate of clients WWB helped to receive public grants (40%) and grants in the European Local Employment Initiative (20%). This figures were estimated by Ms. Berggren, executive-president of WWB Spain who sees in this figures a close relationship (positive correlation) between amount of capital received and survival rate.

contacts, and nine quieter months with 100 initial contacts, and that 25 loans were made in 1998, we can estimate that around 1 in 30 of initial contacts are referred to bank partners.

Loans arranged by WWB are usually not less than 1,000,000 pts and not more than 6,000,000 pts. There are several advantages to clients of arranging their loans through WWB:

- lower interest rates than for loans organised directly (spread of 2%)
- a longer repayment period
- a ‘grace’ period of 1-2 years before repayments must be made
- support in creating a feasible project
- access to grants.

Once clients have received and repayed a loan through WWB, they are generally successful in making direct applications to banks for subsequent loans.

In addition to these loans, WWB also offers an Urgent Credit scheme through Banco Popular Espanol. This is to provide loans for working capital for WWB clients to help them cope with emergency situations. Once the application for urgent credit is received by the bank, decisions are made within 24 hours. Loans are up to 5,000,000 pts and carry very high interest rates. Nevertheless, this scheme makes up 10% of all arranged loans.

Until 1998 WWB only made loans to individuals but the *Credit Solidaire* scheme is based on the Grameen Bank in Bangladesh and offers group loans. The scheme was first introduced in Guadalajara and in early 1999 is to be extended to Segovia. To qualify for Credit Solidaire, groups should consist of 5 women. Loans of up to 5,000,000 pts are made, with a maximum of 1,000,000 per person. Loans can be made without collateral, and women do not provide personal guarantees for each other. The groups are intended only to provide social support, particularly for women in rural areas, and members of the groups are not responsible for the repayment of loans by other members of their group.

Finally, WWB also offers VISA credit cards to clients via Banco Popular Espanol, for which it receives 0.05% commission on each transaction. They have issued around 100 cards – mainly with members of their association - so far. Unfortunately, these cards are issues on the basis of a traditional credit worthiness evaluations and, consequently, many clients cannot gain access to them.

Risk management

WWB does not provide a formal risk management structure apart from preparing the clients to present themselves and their business idea to bank staff and deterring those who are unlikely to be successful.

However, they do reduce the risk faced by new entrepreneurs by offering extensive support during the application process and providing help with developing a business plan. Also the fact that one in two clients return to WWB after the initial bank interview and that nine out of ten receive a loan after they have prepared their application demonstrates that there is an informal but effective selection process. However, this process focuses primarily on the standards of the traditional banks and does not provide an alternative risk-management methodology. This is emphasised by the fact that the initial training of WWBs loan officers was conducted by the bank-partners.

The high repayment rate (98%) with a business survival rate of 50-60% could also indicate that the risk is reduced by a solidarity culture: people repay their loans even if the business fails and they go back into employment. However, it could also indicate that the banks' traditional credit-worthiness evaluation works efficiently in conjunction with a pre-selection and support intermediary such as WWB.

Loan administration and MIS

Currently WWB is not involved in loan administration and does not operate any kind of management information system (MIS). This is all handled by the bank partners which reduces costs for WWB. However, it also makes it difficult for WWB to evaluate its support and selection process because it does not collect any data on repayment and survival rates.

WWB do issue regular mail-outs requesting information from clients but, unfortunately, the response rate is very low. Collecting the information by telephone is also not feasible due to frequently changing telephone numbers and the often irregular working hours of entrepreneurs.

Sources of funding and financial sustainability

WWB receives funding for it's activities from a number of sources.

- All WWB clients pay an annual membership fee of 10,000 pts. Currently they have around 1.000 clients.
- Anyone who receives help from WWB without being a member is charged an arrangement fee of 10,000 pts.
- WWB receives 10% commission on all sales made via the Trade Houses and Trade Fair.

- The Trade Fair, itself, is financed by a consortium of private and public funders.
- WWB also receives payment (by public bodies) for training courses they offer to individuals who are hoping to set up a business. They normally win these training contacts via a process of competitive tender and are usually successful.
- Finally, their biggest source of income is received from public bodies (local, regional, national and European) for administering and delivering grants and running the trade houses.

WWB are not aiming for financial sustainability and the President of WWB is very clear about their objectives in this area. She firmly believes that micro-lending should not be a profit-making activity. She perceives its primary goals to be social, not commercial. From this perspective, making a profit is merely benefiting from other people's disadvantage and, therefore, immoral. Consequently, the president of WWB perceives the key organisational goal to be convincing the state that more public money should be available to help women set up in business. This is illustrated by the following statements:

> *"Whenever there is some additional income we are looking for new social activities to spend it. "*

Much of WWB Spain's work seems rely on the president who oversees relationships with the bank-partners and other funding bodies. She also heads the board, consisting out of influential women from a range of sectors. It is crucial, then, that there is another strong person in the organisation who could take over WWB Spain's work should the current president decide to leave.

Human resources

Currently, WWB Spain employs 23 women. Most of the loan officers are recruited straight from University – five of them are economists and two are lawyers. They are trained by internal staff who originally received training by WWB Spain's bank partners. The salaries paid to loan officers is lower than they would receive in commercial companies and much lower than the traditional banking sector. However, WWB Spain does not seem to have a problem with high staff turnover - only one loan officer has left in recent years. Ms. Berggren sees this as a result of the social commitment of the staff who explained, *"No one would leave to work for a bank"*.

Co-operation with formal financial services

WWB Spain's lending scheme relies on very close co-operation with formal financial services. WWB Spain's first loan officers were trained by their bank partner and, consequently, their selection and preparation process has developed largely to reflect the decision-making which occurs in the traditional banking sector. They are currently working in partnership with five formal banks.

At the initial stage WWB Spain provides basic, factual information to women about how to set up a business, the financial support available through the banking network and how to go about obtaining it. Women who do not have a viable business idea or who would not qualify for a loan are ‚weeded out‘ at this first stage and WWB Spain concentrates its practical support on those who move on to the second stage. At this stage, WWB Spain helps women to make a good case for themselves at the bank by educating and coaching them in the areas that the banks require. Finally, they assist in the production of a business plan which is also designed to conform with the banks‘ requirements.

Non-financial services

Although WWB Spain‘s primary function is micro-lending, the majority of their activities relate to non-financial services. This is largely because they are not permitted, by law, to make loans themselves and also because it is very difficult for them to gain funding to cover their running costs. Consequently, fund-raising is an important element of their work. WWB Spain‘s main non-financial activities relate to their trade houses and the annual trade fair. However, they also offer an advice and training service funded by public grants at local, regional, national and European level.

Benchmarking case-study

Working Capital, USA

Boston, USA

Date of visit: February 4 - 5, 1999

Undertaken by Elaine Kempson, PFRC, Jan Evers and Stefanie Jack, IFF

Objectives and vision

The overall objective of Working Capital is to increase the economic success of self-employed individuals and their communities by providing loans, business education and networking opportunities to entrepreneurs with limited resources (Working Capital Directory, 1998).

the organisation operates through peer group lending, with group members providing advice and practical assistance to one another as well as reviewing and approving one another‘s loan applications. Only around half of members have a loan outstanding at any one time.

Brief history

Working Capital was founded by Jeffrey Ashe in 1990. The first two peer lending groups were organized in Athol, Massachusetts in September of that year, and the first loans were made in October. Following that initial success, staff from eight local organisations were trained in April 1991 to carry out the program in rural sites in Massachusetts, Vermont and New Hampshire. Initially, Working Capital operated through the Institute for Cooperative Economic Development at New Hampshire College. In 1993, Working Capital was organized as a Massachusetts corporation under the name of Peer Partnership, Inc. It now operates as a tax-exempt, non-profit organisation.

From its initial bases in Massachusetts, New Hampshire and Vermont, Working Capital expanded to Maine, and then to Delaware, Florida, Georgia, Missouri and Rhode Island. It began its first international program in Khabarovsk, Russia in 1997. Currently, Working Capital has affiliates in Massachusetts, Rhode Island, Georgia, Florida and Russia and operates its greater Boston program directly from its head office.

All these programs operate on the same basic philosophy and methodology.

More recently, Working Capital has been selling its methodology and associated handbooks to other organisations wanting to establish micro-lending services in the United States. These organisations have not, however, become part of the Working Capital network and do not trade under the name. The development in this direction occurred because it was decided to concentrate on strengthening the existing network rather than continuing to expand.

The rapid growth of Working Capital was putting pressures on the head office that was relying on the original founder to carry out a multiplicity of roles. Consequently in January 1998 the organisation hired a new Executive Director, Jim Kaddaras to manage Working Capital. Mr. Kaddaras reorganised the staff and created two new senior management posts: a Director of Finance and Operations and a Director of Development and Public Affairs. The founder became Director of Programs, Innovation and Research. With a new management team established, Working Capital has put in place improved systems for loan management, for fundraising and for the development of the network.

Organisational structure

Currently, Working Capital has three ‚hubs': Florida, Georgia and Russia; It manages its Massachusetts and its Rhode Island program from its head office. Each of the 'hubs' is an independent, self-contained entity although they all operate within the Working Capital model and use the centrally produced handbooks, software and training materials. Florida operates through more than one affiliate and plans eventually to go state wide. In addition to the Central Office in Miami, Florida has three affiliates: in Palm Beach, and Fort Lauderdale;

The Massachusetts/Rhode Island program has six affiliates in addition to the greater Boston program: in Lawrence, Gloucester, Newport, New Bedford, Springfield, and Palmer. (Five inactive affiliates - in Athol, Gardner, Greenfield, Holyoke and Northampton – are being phased out). Boston and Lawrence are the two largest programs. With the exception of the greater Boston program (which is operated from the head office) these affiliates are based in community organisations in each of their respective cities. They raise their own funding and employ their own staff, but the loan capital is provided by Working Capital along with the loan administration. Like the ‚hubs' they use the Working Capital handbooks and training materials and all staff in the Massachusetts/Rhode Island affiliates are trained centrally.

Target group and client profile

From the promotional leaflet:

Working Capital works best for people who:

- *Own a small business or have a clear, well-developed idea for a business*
- *Are motivated self-starters*
- *Work well in groups and with others*
- *Are willing to commit to the success of their business*

- *Understand that they get out of Working Capital what they put into it'*

In other words, the organisation accepts as clients both people who have established businesses and those wanting to set one up. But, significantly, those joining the Working Capital program must be attracted to the idea of working in groups as this is an essential part of the philosophy and service. This approach is not attractive to all entrepreneurs. It seems to work best with those in the early stages of establishing a business, for whom practical advice and support from peers is important. It seems more attractive to some ethnic groups than others.

Working Capital is committed to assessing its impact and has commissioned surveys in 1992, 1996 and 1998. At the time of writing the 1998 research had not been published. The following figures, therefore, relate to 1996 and the Working Capital Network as a whole (Anthony,1996).

Overall, two-thirds of members were white – reflecting Working Capital's initial work in rural New England. In the Miami program, the majority of members were African-American (54%) or Hispanic (33%). Three quarters (73%) of the Delaware program were African-American. Currently in Massachusetts and Rhode Island some two-thirds of the customers are African-American or Hispanic.

The Lawrence affiliate in Massachusetts draws 90% of its members from the Hispanic (and largely Dominican) population.

The majority of members (73%) had at least some college education, with 38% having at least a college degree. As the program has become more urban and non-white, these figures have declined. Seven out of ten were aged between 30 and 49. Younger people accounted for just 7% of members; 22 per cent were people aged over 50. Two thirds were women and 12% were single mothers.

About a quarter lived below the official poverty line[1] and almost one in five were receiving public assistance. These proportions varied slightly across the programmes in different States. Massachusetts had the highest proportion of members who lived below the poverty line – almost four out of ten, and about five times the proportion in the general population of the State. At the other extreme, only one in 20 of Delaware's members were below the poverty line and this was the only State program where there were fewer poor people in the program than in the population as a whole. So, although it was designed specifically for entrepreneurs with limited resources, Working Capital attracts a broad range of people, with 2 out of 10 of its current members in 1996 having annual household incomes above $30,000 – the median income for most of the States in which it operates.

The majority (78%) of the 1996 members had come to Working Capital with an existing business; 18% had started a business after joining and 4% had never established a business at all. Most were still in business at the time they were

[1] For example, in 1996 this was $7,740 a year for a single individual; $15,600 for a family of four. Currently one third lives below the official poverty line.

surveyed, although the established businesses did rather better (94%) than the start-ups (84%).

Over half of current members in 1996 had applied to a bank for a *personal* loan and 4 out of ten had actually received one. In contrast, fewer than a third had ever applied for a *business* loan and at least 15% did so while they were members of Working Capital. Only 8% were actually given a bank business loan.

Seven out of ten members operated from their own home, but almost a quarter had separate rented premises – shop, office or workshop. Almost half of them had another job as well as running their business; only 16% said their business was their sole source of income.

Due to the following current economic developments Working Capital faces strong competition with regard to client recruitment:

- A decreasing unemployment rate brings more people into jobs. This makes them "bankable" for consumer lending and credit card lending
- Credit card companies have gone “down market” and will lend to anyone with a permanent job
- The concept of micro-lending is becoming very popular in the US and increasingly more institutions provide similar services to Working Capital
- The peer group methodology requires personal motivation and enthusiasm. It does not necessarily require good business skills or a well developed business activity. This makes peer group lending attractive for excluded groups. Under the current positive economic climate, this group has become smaller in size and is concentrated mainly in ethnic groups.[2]

Facts and figures (head office numbers)

1.	Number of loans disbursed since inception	3.000
2.	Amount of loans disbursed since inception	USD 3.000.000
3.	Average loan amount	USD 1.620*
4.	Average loan term in months	9 months
5.	No of employees	12

[2] As Mr. Ashe, the founder of Working Capital commented: "in a recession the market is better for us" The loan officer in Lawrence said: "they have to be in a desperate situation to be interested in our loans ... if you have a full time job, you can get a credit card credit and you have no time for our intensive group programme".

6.	Total number of loans disbursed in 1998	270
7.	Amount of loans disbursed in 1998	USD 365.460
8.	Loan balance outstanding for 1998 (31.10.98)	USD 351.471
9.	Administrative expenditure for 1998	USD 800,000
10.	Credit losses/Write-offs for 1998	28%[3]
11.	Delinquency rate for 1998	13,7 %[4] (90 days overdue)
11.	Income from operations in 1998 (includes customer income, affiliate fees and training)	USD 175,000
12.	Re-financing costs	
13.	Estimated rate of survived enterprises (after three years)	90%

∗ Last quarter of 1998. (Note figures are not currently collected by Working Capital national for the programs outside Massachusetts)

Financial services and credit delivery methodology

Client recruitment

Within the Boston and Lawrence areas (the 2 programs visited and the largest in the network) marketing is fairly wide. Public information meetings are held regularly (twice a month in the Boston program) and these are publicised through the media, leaflets and posters. In addition, in Boston, African-American and Latino outreach workers visit Churches and other community organisations to encourage them to host an information meeting. Groups of 4 to 6 people are set up by individuals who have attended these information meetings and the follow-on member training sessions. They may form a group with others attending the same meeting or with friends and acquaintances – or a mixture of the two. About 50% of the people attending the member training form a group. Those not wanting to set up a group or who are unable to do so can become general, or associate, members. They can use all the support and training services offered by Working Capital, but cannot apply for loans.

[3] Working Capital wrote off a large amount of historical bad debt in 1998. This figure is supposed to be near 5% in the future.

[4] This is declining and is now less than 8%

Enterprise alliances: Because it can be difficult to get groups established, Working Capital has just begun experimenting with a new approach to recruitment – *enterprise alliances*. Existing membership organisations will be identified in the community, with a view to setting up within them group lending schemes involving 10 to 20 people. In early 1999 two organisations (of farmers and of artisans) were in the process of setting up an enterprise alliance. Members of both groups and enterprise alliances are self-selecting. They are not vetted by Working Capital staff. The basic idea is to find strong group networks, to identify the informal and formal group leader/ gatekeeper/ power base of the group and use this system as a self-regulating network: The group and its gatekeepers should use their long term experience with group members to evaluate their credit worthiness. They are able to judge better than any banker or loan officer is able to. This should result in a low delinquency rate. Furthermore the incentive of a step loan methodology results in a larger loan portfolio.

Once established, groups elect someone to chair meetings and a treasurer who will collect loan repayments and pass them to Working Capital. They then meet twice a month to set working through the Working Capital member manual, business curriculum and officer handbooks together. This guides them through determining the by-laws of the group, the loan application process, how to produce a cash flow statement and a business plan to accompany loan applications, how to make decisions regarding group members loan applications and dealing with late payments. Separate officer handbooks provide guidance for the group treasurer, chair and other officers. This usually takes about 6 to 8 meetings in total, but can be longer if the group cannot reach unanimous agreement on the by-laws.

Current Products and plans for future products

The current product is a stepped loan to individuals in groups, and subject to peer review. Working Capital, Massachusetts, are setting up larger groups, or enterprise alliances, which offer a similar product (see above).

There are no plans to diversify into other financial products.

Credit delivery methodology

All loan decisions are made entirely by the business loan group. Enterprise alliances will work in essentially the same way, with a loan committee of four to six persons reviewing and approving loan applicants. Members wanting a loan complete a full application form, which encourages them to assess in detail the strengths and weaknesses of their business, whether a loan is the most appropriate way of financing the proposed development of their business and how they could raise the money to pay back the loan if they were unable to keep up the repayments. It also forces them to produce a cash flow statement as well as a short business plan. Once the form is completed it is given to the other group members who decide whether or not to support the application and if so, whether the applicant should receive the full amount they have applied for. This discussion takes place while the applicant is out of the room. Once an application is agreed it is forwarded to Working Capital for processing.

Cost of services

There are two different fee scales; one for business loan groups and one that will be used for the enterprise alliances.

Business loan group members pay a flat 12% interest on their loans, calculated on a declining balance, plus an average of 4% fees. This interest rate has been set to allow Working Capital to remain competitive against credit unions and credit cards (perceived to be their two main competitors). The prime rate at the time of writing was 8%, with fixed rate bank loans costing 9-11% (generally not available to Working Capital customers). Credit cards charge from 15% to 22% interest.

There is also a fee for membership of Working Capital. In 1999 in the Greater Boston program. This was $120 a year for a chartered group member and $100 a year for general members (or respectively $65 and $55 for 6 months). The membership fee can be paid on a payment plan or through ‘sweat equity‘.

Enterprise alliance members will pay 10.9% interest on loans of less than $10,000; 9.9% for larger loans, plus a 2% origination fee in all cases. These lower rates have been set partly because members are expected to be more established businesses than those in peer groups and partly to encourage greater take-up and an expansion of the loan portfolio.

Loan administration and MIS

In Massachusetts and Rhode Island loans are administered centrally for all the affiliates and the greater Boston program.

Loan cheques are issued twice a month (15th and 30th) and are sent to the group treasurer. Each group treasurer is issued with coupons setting out the monthly loan repayments for each group member, with a new set of coupons issued each time a new loan is taken out or an existing loan is repaid prematurely. At the group’s monthly meeting the treasurer collects the loan repayments from the members who have loans. These are then paid into the group’s bank account and one cheque sent to Working Capital for the total sum due, along with one of the coupons, setting out how much was due from each borrowing member and noting any under-payments.

At Working Capital’s office all payments are recorded on a loan database set up using dBase. A new system was being introduced in early 1999, which uses Microsoft Access and also collects and provides more management information than the one in use since Working Capital was set up. The new system is custom-designed by a consultant and the loans administrator. (For reasons of prudency, both systems will be used parallel for a period)

A monthly listing is produced of all loans, by group. This is used to identify which loans are overdue or underpaid.

Borrowers are allowed to make over-payments but they have to check before the final payment is made to see how much is due. There is no automatic system for dealing with over-payments and they have to be handled individually by the loans administrator.

Risk management

Credit worthiness assessment

All assessments of creditworthiness are made by peer group members. They are given guidance on how best to determine this in the member handbook. This includes assessing

- the character of the applicant: whether they are capable; committed to their business and the group; trustworthy.
- the feasibility of the business plan and the business.
- the applicant‘s contingency plans for paying the loan.

Group members have a loan decision form to guide them in their decision-making, which is done while the applicant is out of the room.

Like many other micro-lenders Working Capital operates a policy of stepped loans. The first loan for a new borrower in a group is $500 (although established businesses can start at $1,000). Successive loans increase in steps to a maximum of $10,000, provided previous loans have been paid on time. The steps are:

- $500 repayable over 4-6 months
- $1,000, repayable over 4-12 months
- $2,000 repayable over 4-18 months
- $4,000 repayable over 4-24 months
- $6,000 repayable over 4-36 months
- $10,000 repayable over 4-36 months

Enterprise alliance members will be eligible for larger loans starting with a loan of up to $2,000 repayable over 4-18 months and increasing to $20,000 which can be repaid in 4-48 months.

Ensuring payment

Prompt payment is ensured by peer pressure from other group members. No further loans are given to the group until all members are up-to-date with repayments. Members are not, however, liable for one anothers loans. But groups do operate a ‚buffer fund' into which members must pay 10% of their loan. This can be used by the group in cases of default.

In addition, charges are made for loans in default. There is a $10 charge for each cheque that is bounced; a $10 charge when a repayment is 15 days late and $1 a day thereafter.

Repayment is also ensured by registering all loans with the credit reference bureau, so any default would affect the borrowers credit history. This is an especially powerful sanction in the United States where ‚having a good credit history' is a matter of some importance to all individuals.

Finally, members who are delinquent on any loan payment may not proceed to the next step up in loan amount until they have repaid one loan with no late payments at all.

Covering losses (Collateral or security)

As noted above, each group has a buffer fund. In addition to the buffer fund, to ensure access to further loans the group could theoretically cover the outstanding debt of a failing group member. However, in practice it seems as though generally all members pay back or fail to do so as a group and consequently no one is ever able to cover the losses of group partners. No other collateral or security is required for loans.

Debt recovery

In 1998, the debt recovery system was tightened up to reduce the level of default. Currently, a reminder letter is sent to the group treasurer and to the borrower when the loan repayment is 15 days late. If payment is still overdue this is followed by two further letters when the loan is 30 days and 60 days late. None of these is worded especially strongly – the intention being that the group should work out with the defaulting borrower how the money owed is to be repaid. If the group can produce an action plan that is approved by the Working Capital loan review committee (comprising both programs and operations representatives) then loan sanctions against the group may be lifted following successful completion of the plan.

If payment is still not made, the debt is handed over to a commercial collection agency retained in 1998, that is paid 29% of the money recovered. It is too early to say how successful this approach will be. If this fails legal proceedings are started – usually when the loan is 120 days late. In Massachusetts, the borrower may be taken to the Small Claims Court if the loan is less than $2,000, otherwise a civil action has to be taken. Working Capital is, however, reluctant to initiate full-blown legal proceedings because of the costs involved.

Sources of funding and operational financial sustainability (including transaction costs)

In the fiscal year 1998, the total income of Working Capital was $930,000. The largest proportion of this (70%) was in the form of grants from private foundations, government and corporations (including banks). About a 15% of the income came from training and affiliation fees paid by organisations buying the Working Capital franchised services. Fees and earned interest charges accounted for about 7% of income. About 7% of income in 1998 came from unearned investment interest and dividends.

A Community Development Finance Institutions Fund (CDFI) award of $800,000 has just been made to Working Capital. This provides $400,000 towards operating costs, $100,000 for technical assistance and $300,000 loan capital at 1% interest due 2007. The recent appointment of a Director of Development and Public Affairs has led to the development of a fundraising strategy for both corporate and individual donors.

Transaction costs are currently running more than $2 for every $1 borrowed. It is hoped that this will fall when the enterprise alliances are set up as these will offer larger loans.

In other words, Working Capital are working towards greater operating efficiency but accept that they will almost certainly never become fully self-sustainable financially, with their current lines of business.

Our research group estimates the sustainability rate in 1998 only between 0-10% due to high bad debt write-offs. In 1999 with a better loan portfolio and some success with the enterprise alliance scheme the sustainability rate could increase to 20-30%. The potential for sustainability under the current WC strategy is seen at 40%, due to the strong support package delivered by WC and a highly disadvantaged client group.

Co-operation with formal financial sector

BankBoston is a major supporter of Working Capital. In addition, this bank is prepared to look favourably on loan applications from Working Capital members although a credit check will be undertaken. A new arrangement has recently been set up with the Cambridge Savings Bank, which will match $ for $ any loan given to a Working Capital member living in their service area without a credit check, after the member has repaid two Working Capital loans.

Another recent development has been a ‚bank links’ breakfast meeting to assist in forging closer links with banks.

Non-financial services such as Business Advisory Services (BAS)

One of the strengths of Working Capital is the practical help and support that membership brings. In addition to being able to access loans, members are provided with a wide range of other non-financial services, including:

- Advice and support from their loan group members
- Practical help with cash flow management and business planning through the members self-help handbooks
- Access to free legal advice from a local law firm
- The opportunity to build a credit history
- The opportunity to network with other members of Working Capital through meetings, seminars, special fairs and exhibitions
- Listing in the annual directory of members, which is circulated widely and should lead to additional customers

Interviews with borrowers indicate that for those just setting up a business, these non-financial services are more important to them than the loans.

MicroFinance Network Basic Statistics (December 1998)

Compiled by the MicroBanking Bulletin

Member	Number of Active Borrowers	Growth Rate	% Women Loan Clients	Average Loan Balance	Outstanding Portfolio (M US$)	Portfolio at Risk > 90 Days**	Value of Deposits (M US$)
	(no.)	(%)	(%)	(US$)	(US$)	(%)	(US$)
ABA, Egypt	16,070	11%	12.0%	781	$12.6	1.2%	0
ACEP, Senegal	6,500	18%	30.0%*	1,680	$10.9	0.3%	$0.07
ACLEDA, Cambodia	62,215	22%	NA	162	$10.1	NA	0
ASA, Bangladesh	786,492	24%	93.4%	$65	$44.2	NA	$21.6
Banco ADEMI, Dominican Republic	9,855	NA	36.0%	3,202	$31.6	0.4%	$8.2
BancoSol, Bolivia	81,555	8%	68.0%	908	$74.1	1.6%	$54.3
Banco del Desarrollo, Chile	15,013	-24%	49.0%	1,076	$16.2	NA	$1.4
BRAC, Bangladesh	2,003,789	18%	100.0%	53	$106.5	2.8%	0
BRI Unit Desa, Indonesia	2,457,652	-6%	27.0%	238	$585.3	1.7%	$2012.0
Caja Los Andes, Bolivia	30,309	NA	58.0%	944	$28.6	1.0	$11.2
Centenary Rural Dvpmt. Bank Ltd., Uganda	9,923	48%	25.0%	863	$8.4	2.1%	$14.6
CHISPA, Nicaragua	6,610	9%	72.0%	299	$2.0	2.2%	0
Citi Savings & Loans Co. Ltd., Ghana	3,400	12%	80.0%*	480	$1.3	7.9%	$2.3
Compartamos, Mexico	43,401	NA	100.0%	66	$2.9	0.8%	0
Cooperativa Emprender****, Colombia	44	7%	NA	130,685	$5.8	0.5%	0
FINAMERICA, Colombia	9,798	2%	48.0%	1,425	$14.0	4.3%	$8.4
Fundacion Emprender, Argentina	2700	-16%	42.0%	1,064	$1.8	11.6%	0
FED, Ecuador	11,596	-3%	64.0%	293	$3.4	NA	0
FINCA Kyrgystan	9,944	NA	90.0%	85	$0.8	NA	0
Fundusz Mikro, Poland	8,561	53%	38.0%	988	$8.5	3.6%	0
K-Rep*, Kenya	13,970	NA	58.0%	$354	$3.8	Na	$1.6
Kafo Jiginew, Mali	32,700	17%	16.70%	174	$5.7	3.7%	$4.2
Mibanco, Peru	33,858	NA	62.0%	358	$12.1	0.8%	$8.4
PRIDE Tanzania	21,006	NA	65.0%	105	$2.2	0	0
PRODEM, Bolivia	47,130	23%	65.0%	512	$24.2	0.3%	0
SEWA Bank*, India	8,000	33%	100.0%	415	$2.1	NA	$5.0
TSPI, Philippines	8,187	-8%	84.0%	340	$2.8	1.8%	0
Network Totals	5,740,278	12.00%	56.36%	$199****	$1021.90		$2153.27

* 1997 data from the MicroFinance Network.
** In past reports, the MicroFinance Network reported portfolio at risk > 30 days.
*** Number represents total loan portfolio of all Network institutions divided by total number of borrowers.
**** Cooperativa-Emprender is a cooperative that lends to microfinance institutions.

MicroFinance Network Detailed Statistics

Compiled by the MicroBanking Bulletin

MFI Name	Unadjusted Return on Assets net operating income / avg total assets (%)	Adjusted Return on Assets adjusted net operating income / avg total assets (%)	Adjusted Return on Equity adjusted net operating income / avg equity (%)	Operational Self-Sufficiency operating income / operating expense (%)
ABA, Egypt	5.7%	3.2%	5.7%	165.2%
ACEP, Senegal	10.7%	9.9%	14.9%	220.7%
ACLEDA, Cambodia	7.5%	6.2%	8.9%	122.8%
BancoADEMI, S.A.	9.8%	1.4%	6.4%	180.3%
BancoSol, Bolivia	5.6%	5.2%	37.1%	122.6%
Bandesarrollo Microempresas, Chile	-5.7%	NA	NA	NA
BRAC, Bangladesh	10.2%	6.9%	12.1%	181.5%
BRI, Unit Desa, Indonesia	5.9%	3.8%	60.4%	119.9%
Caja Los Andes, Bolivia	4.5%	4.5%	36.8%	118.3%
Centenary Rural Dev. Bank, Uganda	2.3%	2.5%	34.5%	108.3%
CHISPA, Nicaragua	8.5%	1.6%	2.3%	118.7%
Citi Savings & Loans, Ghana	-8.4%	-11.1%		73.2%
Compartamos, Mexico	26.3%	15.7%	17.7%	143.5%
Cooperativa Emprender, Colombia	1.0%	0.4%	1.2%	104.0%
Finamérica, Colombia	-3.8%	-6.2%	-23.4%	89.4%
FINCA Kyrgyzstan	9.1%	4.2%	4.6%	117.9%
FED, Ecuador	27.3%	15.1%	29.7%	168.5%
Fundacion Emprender, Argentina	-10.5%	-13.8%	-136.8%	87.3%
Fundusz Mikro, Poland	4.4%	-3.7%	-3.8%	115.6%
Kafo Jiginew, Mali	0.6%	-0.1%	-0.5%	104.7%
Mibanco, Peru	3.1%	2.5%	7.0%	107.7%
PRIDE Tanzania	-22.9%	-27.2%	-55.3%	59.6%
PRODEM, Bolivia	8.3%	4.9%	9.5%	132.0%
SEWA Bank, India*				192.9%
TSPI Developm. Corp., Philippines	-6.6%	-9.0%	-18.2%	77.3%
Average	**3.9%**	**0.7%**	**2.3%**	**126.3%**

MFI Name	Financial Self-Sufficiency adjusted operating income / adjusted operating expense (%)	Asset Utilization operating income / avg total assets (%)	Profit Margin adjusted net operating income / operating income (%)	Interest Margin adjusted net margin / avg total assets (%)
ABA, Egypt	128.8%	14.5%	22.3%	7.1%
ACEP, Senegal	203.9%	19.5%	50.9%	17.6%
ACLEDA, Cambodia	118.2%	40.3%	15.4%	34.9%
BancoADEMI, S.A.	107.0%	22.0%	6.6%	8.9%
BancoSol, Bolivia	120.6%	30.4%	17.1%	22.1%
Bandesarrollo Microempresas, Chile	NA	NA	NA	NA
BRAC, Bangladesh	143.7%	22.8%	30.4%	16.9%
BRI, Unit Desa, Indonesia	112.0%	35.8%	10.7%	7.4%
Caja Los Andes, Bolivia	118.3%	28.8%	15.5%	20.1%
Centenary Rural Dev. Bank, Uganda	109.2%	29.4%	8.5%	28.2%
CHISPA, Nicaragua	103.0%	54.3%	2.9%	45.0%
Citi Savings & Loans, Ghana	67.4%	23.0%	-48.3%	6.4%
Compartamos, Mexico	122.0%	86.8%	18.1%	75.4%
Cooperativa Emprender, Colombia	102.0%	24.2%	1.5%	6.6%
Finamérica, Colombia	84.0%	32.3%	-19.1%	11.7%
FINCA Kyrgyzstan	107.6%	59.9%	7.1%	55.1%
FED, Ecuador	129.1%	67.1%	22.5%	34.3%
Fundacion Emprender, Argentina	83.9%	71.7%	-19.2%	52.7%
Fundusz Mikro, Poland	89.8%	32.4%	-11.4%	24.3%
Kafo Jiginew, Mali	99.2%	14.3%	-0.9%	11.3%
Mibanco, Peru	106.1%	43.1%	5.7%	35.6%
PRIDE Tanzania	55.4%	33.8%	-80.4%	29.6%
PRODEM, Bolivia	117.0%	34.0%	14.6%	25.3%
SEWA Bank, India*	79.2%			
TSPI Developm. Corp., Philippines	71.5%	22.5%	-39.8%	15.2%
Average	**107.4%**	**36.6%**	**1.3%**	**25.7%**

MicroFinance Network Detailed Statistics

Compiled by the MicroBanking Bulletin

MFI Name	Portfolio Yield interest income from portfolio / avg loan portfolio (%)	Real Yield portfolio yield – inflation rate / (1 + inflation rate) (%)	Operating Expense / Total Assets adjusted operating expense / avg total assets (%)	Interest Expense / Total Assets interest expense / avg total assets (%)
ABA, Egypt	26.3%	20.8%	11.3%	5.0%
ACEP, Senegal	21.6%	20.2%	10.4%	1.2%
ACLEDA, Cambodia	49.9%	30.6%	33.1%	4.2%
BancoADEMI, S.A.	24.7%	19.4%	20.4%	4.7%
BancoSol, Bolivia	36.3%	26.6%	25.2%	7.9%
Bandesarrollo Microempresas, Chile	NA	NA	NA	NA
BRAC, Bangladesh	27.4%	20.6%	15.8%	2.5%
BRI, Unit Desa, Indonesia	41.9%	-10.0%	32.0%	26.3%
Caja Los Andes, Bolivia	29.6%	20.4%	24.5%	8.7%
Centenary Rural Dev. Bank, Uganda	56.0%	48.6%	26.9%	1.4%
CHISPA, Nicaragua	61.3%	47.7%	56.2%	2.3%
Citi Savings & Loans, Ghana	39.7%	21.9%	34.0%	13.9%
Compartamos, Mexico	110.5%	81.6%	71.1%	0.8%
Cooperativa Emprender, Colombia	33.5%	9.6%	25.2%	16.9%
Finamérica, Colombia	40.4%	15.3%	42.7%	18.3%
FINCA Kyrgyzstan	107.7%	82.9%	55.7%	0.0%
FED, Ecuador	100.9%	47.6%	52.0%	20.6%
Fundacion Emprender, Argentina	73.0%	67.3%	85.5%	15.7%
Fundusz Mikro, Poland	33.9%	15.4%	34.8%	0.0%
Kafo Jiginew, Mali	19.9%	15.3%	18.8%	2.2%
Mibanco, Peru	64.6%	53.6%	40.6%	6.9%
PRIDE Tanzania	54.3%	36.8%	61.0%	-0.1%
PRODEM, Bolivia	41.4%	31.3%	29.0%	5.3%
SEWA Bank, India*				
TSPI Developm. Corp., Philippines	32.7%	26.2%	31.5%	5.0%
Average	**49.0%**	**32.6%**	**36.4%**	**7.4%**

MFI Name	Adjustment Expense / Total Assets adjustment expense / avg total assets (%)	Loan Loss Provision Expense / Total Assets provision expense / avg total assets (%)	Salary Expense / Total Assets staff expenses / avg total assets (%)	Other Admin Expenses / Total Assets other admin. expenses / avg total assets (%)
ABA, Egypt	2.5%	0.1%	2.3%	1.4%
ACEP, Senegal	0.7%	1.3%	4.6%	2.6%
ACLEDA, Cambodia	1.3%	1.4%	16.3%	9.9%
BancoADEMI, S.A.	8.3%	0.0%	5.7%	1.7%
BancoSol, Bolivia	0.4%	2.9%	8.6%	5.4%
Bandesarrollo Microempresas, Chile	NA	4.0%	8.9%	8.3%
BRAC, Bangladesh	3.3%	-1.3%	7.9%	3.3%
BRI, Unit Desa, Indonesia	2.1%	-0.4%	2.4%	1.6%
Caja Los Andes, Bolivia	0.0%	3.4%	8.5%	3.8%
Centenary Rural Dev. Bank, Uganda	-0.2%	4.5%	9.5%	11.7%
CHISPA, NICARAGUA	7.0%	4.2%	22.8%	19.8%
Citi Savings & Loans, Ghana	2.7%	4.3%	7.0%	6.2%
Compartamos, Mexico	10.7%	4.1%	29.5%	26.1%
Cooperativa Emprender, Colombia	0.6%	0.9%	2.5%	4.3%
Finamérica, Colombia	2.3%	3.6%	10.8%	7.7%
FINCA Kyrgyzstan	4.9%	1.1%	31.8%	17.9%
FED, Ecuador	12.2%	2.8%	5.7%	10.7%
Fundacion Emprender, Argentina	3.3%	9.3%	43.7%	13.5%
Fundusz Mikro, Poland	8.1%	3.1%	15.3%	8.3%
Kafo Jiginew, Mali	0.8%	2.9%	4.5%	8.4%
Mibanco, Peru	0.6%	1.6%	19.8%	11.6%
PRIDE Tanzania	4.3%	0.6%	29.7%	26.5%
PRODEM, Bolivia	3.4%	2.5%	10.3%	7.5%
SEWA Bank, India*				
TSPI Developm. Corp., Philippines	2.3%	1.7%	13.0%	9.5%
Average	**3.5%**	**2.4%**	**13.4%**	**9.5%**

MicroFinance Network Detailed Statistics

Compiled by the MicroBanking Bulletin

MFI Name	Admin Expense / Loan Portfolio total admin. expense / avg loan portfolio (%)	Salary Expense / Loan Portfolio staff expenses / avg loan portfolio (%)	Portfolio at Risk > 30 days outstanding balance overdue > 30 days / total loan portfolio (%)	Avg Loan Balance / GNP per capita avg loan balance / GNP per capita (%)
ABA, Egypt	6.8%	4.2%		65.1%
ACEP, Senegal	7.9%	5.0%	4.1%	311.1%
ACLEDA, Cambodia	32.4%	20.2%		54.0%
BancoADEMI, S.A.	8.6%	6.7%	1.6%	183.0%
BancoSol, Bolivia	17.2%	10.6%	2.3%	93.6%
Bandesarrollo Microempresas, Chile	8.9%	8.4%	8.8%	22.3%
BRAC, Bangladesh	14.1%	10.0%		14.7%
BRI, Unit Desa, Indonesia	12.4%	7.4%		21.4%
Caja Los Andes, Bolivia	13.4%	9.3%		97.3%
Centenary Rural Dev. Bank, Uganda	42.6%	19.1%	2.3%	261.5%
CHISPA, NICARAGUA	48.5%	26.0%	5.1%	72.9%
Citi Savings & Loans, Ghana	25.5%	13.4%	9.0%	123.1%
Compartamos, Mexico	74.1%	39.3%		1.8%
Cooperativa Emprender, Colombia	9.6%	3.5%	0.5%	
Finamérica, Colombia	23.8%	13.8%	8.4%	65.4%
FINCA Kyrgyzstan	89.5%	57.2%		17.7%
FED, Ecuador	34.1%	11.9%		18.7%
Fundacion Emprender, Argentina	58.2%	44.5%		13.3%
Fundusz Mikro, Poland	34.9%	22.6%		27.5%
Kafo Jiginew, Mali	19.1%	6.7%		66.9%
Mibanco, Peru	47.2%	29.8%	3.4%	13.7%
PRIDE Tanzania	91.2%	48.3%	0.0%	50.0%
PRODEM, Bolivia	24.8%	14.4%	1.0%	52.8%
SEWA Bank, India*		5.3%	1.0%	122.1%
TSPI Developm. Corp., Philippines	32.6%	18.8%		28.3%
Average	**32.4%**	**18.3%**	**3.7%**	**74.9%**

MFI Name	Salary Structure avg staff salary / GNP per capita (X)	Physical Productivity of Staff no. active loan clients / no. staff (no.)	Cost per Client total administrative expense / no. active loan clients (US$)	GNP per capita (US$)
ABA, Egypt	1.8	72	54	1,200
ACEP, Senegal	12.9	89	133	540
ACLEDA, Cambodia	19.8	229	49	300
BancoADEMI, S.A.	4.3	46		1,750
BancoSol, Bolivia	11.6	129	146	970
Bandesarrollo Microempresas, Chile	2.7	117	184	4,820
BRAC, Bangladesh	5.0	384	7	360
BRI, Unit Desa, Indonesia	1.8	117	28	1,110
Caja Los Andes, Bolivia	10.8	142	113	970
Centenary Rural Dev. Bank, Uganda	14.4	34	377	330
CHISPA, NICARAGUA	12.4	86	130	410
Citi Savings & Loans, Ghana	9.0	63		390
Compartamos, Mexico	1.1	198	45	3,700
Cooperativa Emprender, Colombia	8.5	4		2,180
Finamérica, Colombia	4.4	62	265	2,180
FINCA Kyrgyzstan	5.5	78	67	480
FED, Ecuador	1.8	89	91	1,570
Fundacion Emprender, Argentina	3.2	87		8,030
Fundusz Mikro, Poland	4.1	91	302	3,590
Kafo Jiginew, Mali	16.9	442	31	260
Mibanco, Peru	5.1	127	171	2,610
PRIDE Tanzania	28.9	144		210
PRODEM, Bolivia	9.7	149	120	970
SEWA Bank, India*	4.7	114		340
TSPI Developm. Corp., Philippines	1.8	37	115	1,200
Total		**3,131**		
Average	**8.1**	**125**	**128**	**1,619**

MicroFinance Network Detailed Statistics

Compiled by the MicroBanking Bulletin

MFI Name	GDP growth rate average annual growth in GDP, 1990-97 (%)	Inflation Rate (%)	Deposit Rate (%)	Financial deepening M3 / GDP (%)
ABA, Egypt	4.00%	4.60%	9.60%	82.20%
ACEP, Senegal	2.50%	1.20%	3.50%	
ACLEDA, Cambodia	5.50%	14.80%	7.80%	11.70%
BancoADEMI, S.A.	5.10%	4.40%	17.65%	25.00%
BancoSol, Bolivia	4.10%	7.70%	12.82%	47.30%
Bandesarrollo Microempresas, Chile	8.30%	5.10%	14.90%	45.20%
BRAC, Bangladesh	4.70%	5.60%	8.70%	30.30%
BRI, Unit Desa, Indonesia	7.50%	57.60%	39.07%	55.60%
Caja Los Andes, Bolivia	4.10%	7.70%	12.82%	47.30%
Centenary Rural Dev. Bank, Uganda	7.40%	5.00%	11.36%	11.00%
CHISPA, NICARAGUA	4.10%	9.20%	10.80%	44.10%
Citi Savings & Loans, Ghana	4.20%	14.60%	32.05%	16.00%
Compartamos, Mexico	2.20%	15.90%	13.75%	30.10%
Cooperativa Emprender, Colombia	4.40%	21.80%	32.60%	38.90%
Finamérica, Colombia	4.40%	21.80%	32.60%	38.90%
FINCA Kyrgyzstan	-9.50%	13.60%	35.80%	
FED, Ecuador	3.10%	36.10%	39.39%	30.00%
Fundación Emprender,Argentina	5.40%	3.40%	11.90%	20.80%
Fundusz Mikro, Poland	4.10%	16.10%	19.40%	39.60%
Kafo Jiginew, Mali	3.30%	4.00%	3.50%	12.10%
Mibanco, Peru	6.20%	7.20%	18.70%	23.00%
PRIDE Tanzania	3.90%	12.80%	7.75%	21.90%
PRODEM, Bolivia	4.10%	7.70%	12.80%	47.30%
SEWA Bank, India*				
TSPI Developm. Corp., Philippines	3.30%	5.10%	10.19%	55.00%
Average	**4.02%**	**12.63%**	**17.48%**	**35.15%**

** Data from 1997*