



Microfinance programmes and the utilization of public money

Comprehensive study

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Introduction

Background of the study

In the post-crisis era significant interventions have been made by both the European Union and Member States to ease conditions for SMEs to raise capital in the financial market. Nevertheless, many efforts are yet needed to remove obstacles to accessing finance and addressing financial exclusion; microfinance offered through various modalities across Europe has therefore remained a crucial instrument. In the short term it helps to realize prospective, however not yet bankable projects. The investments, in the medium-long term, improve the companies' competitiveness, lead to the opening up of new job opportunities and eventually contribute to local wealth creation. Moreover, the importance of the social aspects of reducing disparities, poverty and promoting inclusive growth cannot be overstated.

On the above recognition, the Interreg Europe project „Access to Microfinance for Small and Medium-sized Enterprises” aims at unlocking further potential of microfinance schemes operated in nine European regions.

Research objectives

The objective of the requested analysis is to provide synthetic input about the experience gained so far in the relevant Member States as regards the practical implementation of the legislative framework governing financial instruments (FI) and microfinance. Central to the project is increasing the efficiency of programmes financed from public funds. Correspondingly, the study explores international experiences in managing such public funded schemes as well as a strong emphasis will be placed on presenting to what extent relevant international expert guidance and recommendations have been embedded. The following analyses will serve as a basis for the elaboration of the study.

With regard to the general objective outlined above, the following questions shall be addressed and explored in the analysis:

- Does the current legal framework provide legal certainty on microfinance?
- What kind of financing instruments are available at the different levels (EU, national, interregional, regional) that offer opportunities for the European microfinance sector?
- How are the new EU provisions applied in the Member States? Are international guidance documents/recommendations applied in practice (IPFI: 2012. Budapest; MicroFiNet: 2016. Roma)?
- What are the main issues emerging at this stage of policy implementation?

Taking into account the state of play of implementation, the analysis shall in particular address the following more specific themes:

- to what extent the recommendations of professional organisations are taken into account in terms of programme characteristics, access conditions and implementing rules (IPFI: 2012. Budapest; MicroFiNet: 2016. Rome),
- how are the fundamental principles implemented,
- what conflicts may arise between the recommendations, directives, the programme criteria (for example: CoGC) and the delivery mechanisms. Analysis of CoGC recommendations in terms of adaptability, compliance and practical experiences of the implementation.

The analysis shall deliver conclusions that might be relevant for all EU Member States. The analysis shall be carried out with a focus on Member States participating in the Interreg Europe project „Access to Microfinance for Small and Medium-sized Enterprises”, and it shall include evidence from other Member States, where appropriate.

Executive summary

In the post-crisis era significant interventions have been made by both the European Union and Member States to ease conditions for SMEs to raise capital in the financial market. Nevertheless, many efforts are yet needed to remove obstacles to accessing finance and addressing financial exclusion; microfinance offered through various modalities across Europe has therefore remained a crucial instrument. In the short term it helps to realize prospective, however not yet bankable projects. The investments, in the medium-long term, improve the companies' competitiveness, lead to the opening up of new job opportunities and eventually contribute to local wealth creation. Moreover, the importance of the social aspects of reducing disparities, poverty and promoting inclusive growth cannot be overstated.

Concerning the above, research has been carried out with the involvement of ten project partners from seven different EU Member States (Hungary, Spain, Germany, Italy, Croatia, Poland, Belgium) and Norway. The partners included a range of institutions, namely managing authorities, microfinance institutions and organizations entrusted with the development of enterprises¹. Besides a general overview of the situation and issues concerning microfinance in Europe, an in-depth study has been carried out of the experiences with SME finance and microfinance in six EU Member States (Hungary, Italy, Germany, Spain, Croatia, Poland).

The overall objective of the project is to improve the implementation of policies addressing enterprise development or sustainable employment in the participating regions, so that they can contribute to a better access to local microfinance programs for SMEs and self-entrepreneurs. The project is expected to enable regional authorities and business development organizations to develop adequate local responses to one of the key obstacles that start-ups and self-entrepreneurs are facing, i.e. the lack of credit, business development services, and financial exclusion. In the frame of the research, the relevant stakeholders have been interviewed through surveys and stakeholder group meetings and their experiences have been shared in study trips and local workshops. A total of 12 stakeholder meetings have been organized by each partner, with study trips and local workshops for each partner. The results will be communicated also to policymakers and an action plan for implementing results will also be set up.

The aim of the present study is to provide a short overview of the analysis being carried out as part of the project on the access to finance for SMEs. The main focus on one hand is on the theoretical, practical and regulatory issues related to microfinance in Europe and on the other hand the experience of Member States studied as regards providing microfinance.

¹ Participating organisations were the following: Fejér Enterprise Agency (HU), Ministry for National Economy Deputy State Secretariat Responsible for Implementing Economic Development Programs (HU), European Business and Innovation Centre of Burgos (CEEI Burgos) (ES), KIZ SINNOVA company for social innovation gGmbH (DE), Zala County Foundation for Enterprise Promotion (HU), Autonomous Region of Sardinia Regional Department for Planning (IT), PORA Regional Development Agency of Podravina and Prigorje for Promotion and Implementation of Development Activities in Koprivnica Krizevci County (HR), Microfinance Norway (NO), Świętokrzyskie Region – Marshal Office of Świętokrzyskie Region (PL), European Microfinance Network EMN aisbl (BE).

Correspondingly, the study explores international experiences in managing such public funded schemes, as well as a strong emphasis will be placed on presenting to what extent relevant international expert guidance and recommendations have been embedded.

European SMEs in general suffer from a lack of commercial sources of finance. The main problem is that many firms are deemed non-bankable by commercial banks, such as micro firms or small firms with little or no credit history. For better situated firms, funding is available from both banks and other non-bank institutions, although the latter are subject to less regulation at EU and at national level. For other firms' various government supported initiatives exist to support those that struggle to obtain commercial forms of financing, especially loans. A popular way of support is the use of EU funding from ESIF operational programs in the form of various financial instruments, although in a number of countries various regional funds and other regional initiatives of support exist.

It is suggested that within the EU, there should be a separation between small loans that can be supplied by a bank to bankable borrowers, and those cases that should indeed be handled by a Microfinance Institution (MFI) or development banks (the non-bankable segment of the market). Nevertheless, it should be recognized that in some markets banks provide or support microfinance services to the non-bankable sector as well, mainly as social responsibility. In the longer run, these activities may allow some borrowers to migrate from the non-bankable to the bankable sector. Whatever the pattern of the microfinance business in a market, it is important to avoid confusion between the bankable and non-bankable kinds of business. Each type has its distinct objectives, risk profiles, and rewards, which should be as transparent as possible.

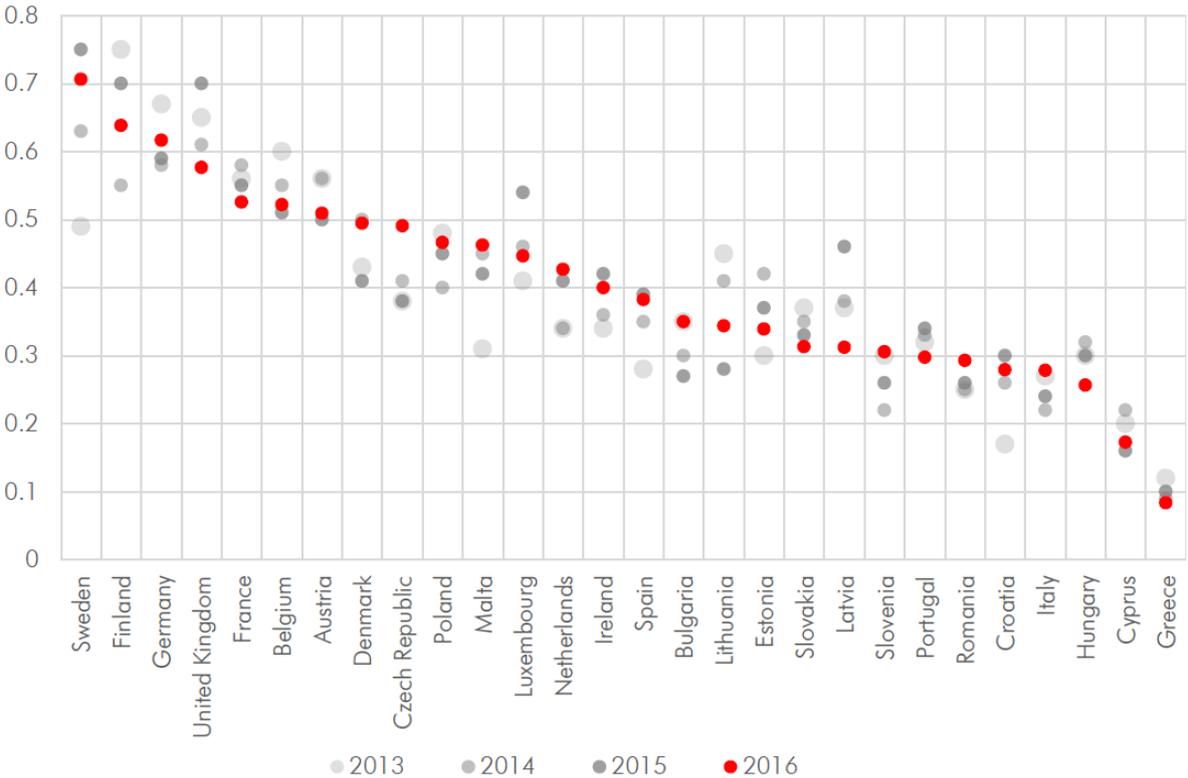
Microfinance in Europe

1. SME finance in EU

Broadening access to finance for SMEs - start-ups, innovative companies and other unlisted firms - is at the heart of the Capital Markets Union (CMU) Action Plan². On average around 60% of start-ups survive the first three years of activity, and those that do, contribute disproportionately to job creation³. Young firms account for an average of only 17% of employment, but they create 42% of new jobs⁴.

The recent EIF SME Finance Index – as a composite indicator that summarizes the state of SME financing in 27 EU countries - reveal some interesting findings when considering the evolution of the index over time. Greece, for example, has experienced a gradual but consistent deterioration of its index value. Comparing 2015 to 2016, the countries experiencing the biggest set-back in their SME Finance index were Latvia, the United Kingdom and Luxembourg. The biggest improvements were recorded by the Czech Republic, Denmark and Bulgaria.

Figure 1: The EIF SME Finance Index: Country comparison and evolution over time



² Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, COM(2015) 468/2, 30.09.2015.

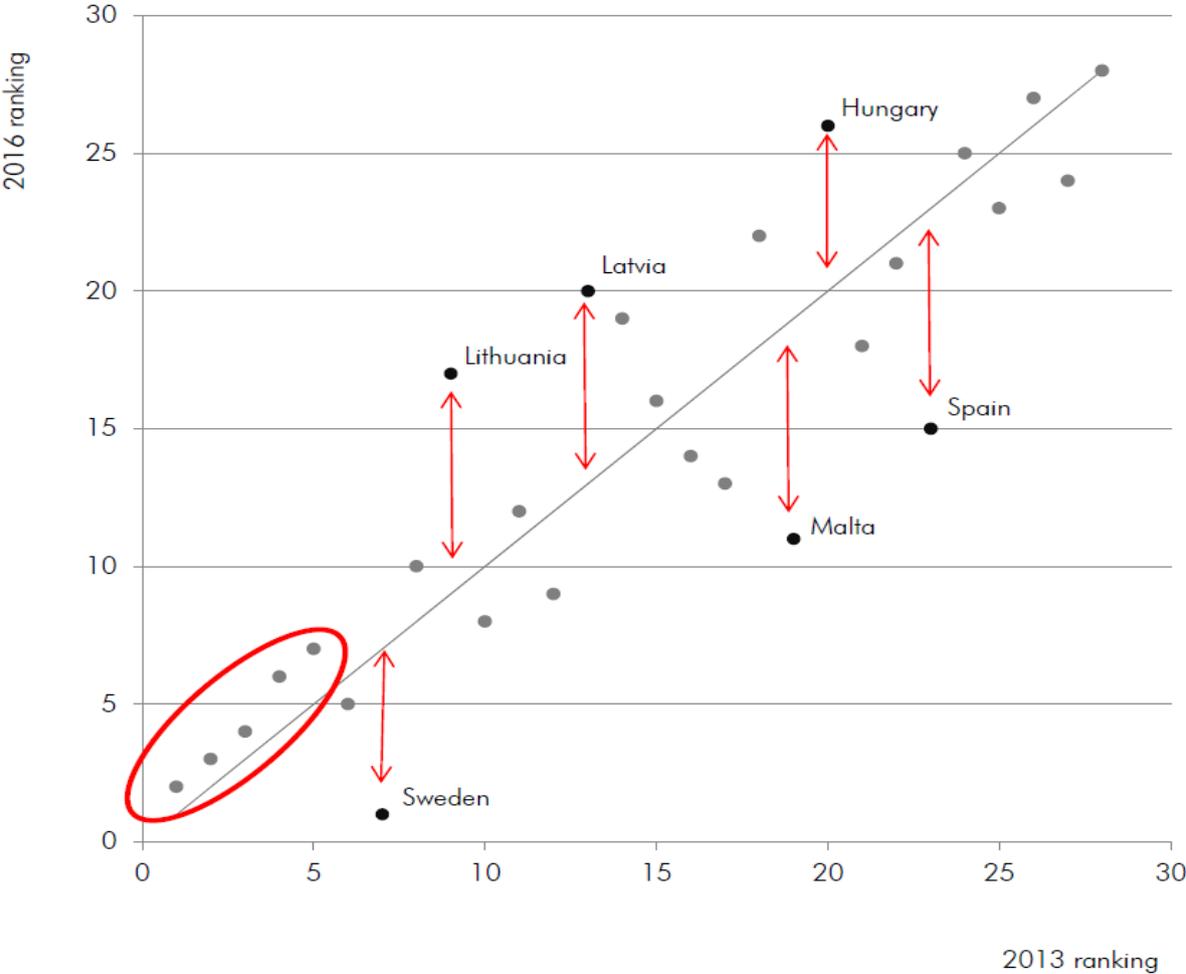
³ OECD (2015), OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society, OECD Publishing, Paris

⁴ OECD Science, Technology and Industry Policy Papers, No. 29, OECD Publishing, Paris

Source: Capstone project SME Finance Index

There are a number of countries that shifted significantly within the distribution of figures, both upwards and downwards: Lithuania (-8 places), Latvia (-7 places) and Hungary (-6 places) all slid down in the hierarchy significantly. On the other hand, Spain, Malta (+8 places) and Sweden (+6 places) improved their relative position.

Figure 2: The EIF SME Finance Index: ranking comparison, 2013 vs 2016



Source: Capstone project SME Finance Index

Having sufficient access to finance is an important determinant for the development of an enterprise. Securing finance is rarely a core strength of smaller businesses and entrepreneurs, which often lack the resources to employ a dedicated team for managing their finances.

European SMEs receive 75% of their funding from banks. However, their financing needs cannot always be serviced by banks in the amounts or on the terms needed. And this over-exposes SMEs to tightening bank lending policies. Despite a significant improvement in the availability of bank financing over the last years, SMEs in some Member States still face a lack of access to credit.

2. Definition and characteristics of micro firms

Informal microcredit has existed in Europe for centuries. The first official institutions concerned with credit to the poor were the Monte di Pieta in Italy in the 15th century. They were followed in the 19th century by savings and credit cooperatives aimed at combating usury that oppressed the peasantry, initiated by Raiffeisen in Germany. The former helped to develop pawn broking, accessible to low-income clients; the latter were the forerunners of mutualist banks, having all the functions of banks, as well as of credit unions oriented primarily towards savings and small personal credit.

Some principles that summarize a microfinance practice were encapsulated in 2004 by CGAP and endorsed by the Group of Eight leaders at the G8 Summit on June 10, 2004⁵:

- Poor people need not just loans but also savings, insurance and money transfer services.
- Microfinance must be useful to poor households: helping them raise income, build up assets and/or cushion themselves against external shocks.
- "Microfinance can pay for itself." Subsidies from donors and government are scarce and uncertain and so, to reach large numbers of poor people, microfinance must pay for itself.
- Microfinance means building permanent local institutions.
- Microfinance also means integrating the financial needs of poor people into a country's mainstream financial system.
- "The job of government is to enable financial services, not to provide them."
- "Donor funds should complement private capital, not compete with it."
- "The key bottleneck is the shortage of strong institutions and managers." Donors should focus on capacity building.
- Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.
- Microfinance institutions should measure and disclose their performance — both financially and socially.

Microfinance is considered a tool for socio-economic development, and can be clearly distinguished from charity. Families who are destitute, or so poor they are unlikely to be able to generate the cash flow required to repay a loan, should be recipients of charity. Others are best served by financial institutions.

In Europe formal microfinance began in the 1990s:

⁵ Helms, Brigit (2006). *Access for All: Building Inclusive Financial Systems*. [Washington, D.C.: The World Bank](#). ISBN 0-8213-6360-3.

- in Western Europe persistent unemployment and pressure on the welfare state focused attention on microcredit as a tool to foster self-employment for financially and socially excluded persons;

- in Eastern Europe after the economic transition from centrally planned to market economies, which led to large numbers of unemployed urban and rural workers, microfinance institutions were created with significant donor support. Their purpose was to provide services to people not reached by formal financial institutions due to the collapse of the financial sector. The priority was to create viable and sustainable financial institutions that could reach large numbers of unemployed and poor workers.

In both cases most funds received public sector subsidies and microlenders focused on promoting social and financial inclusion.

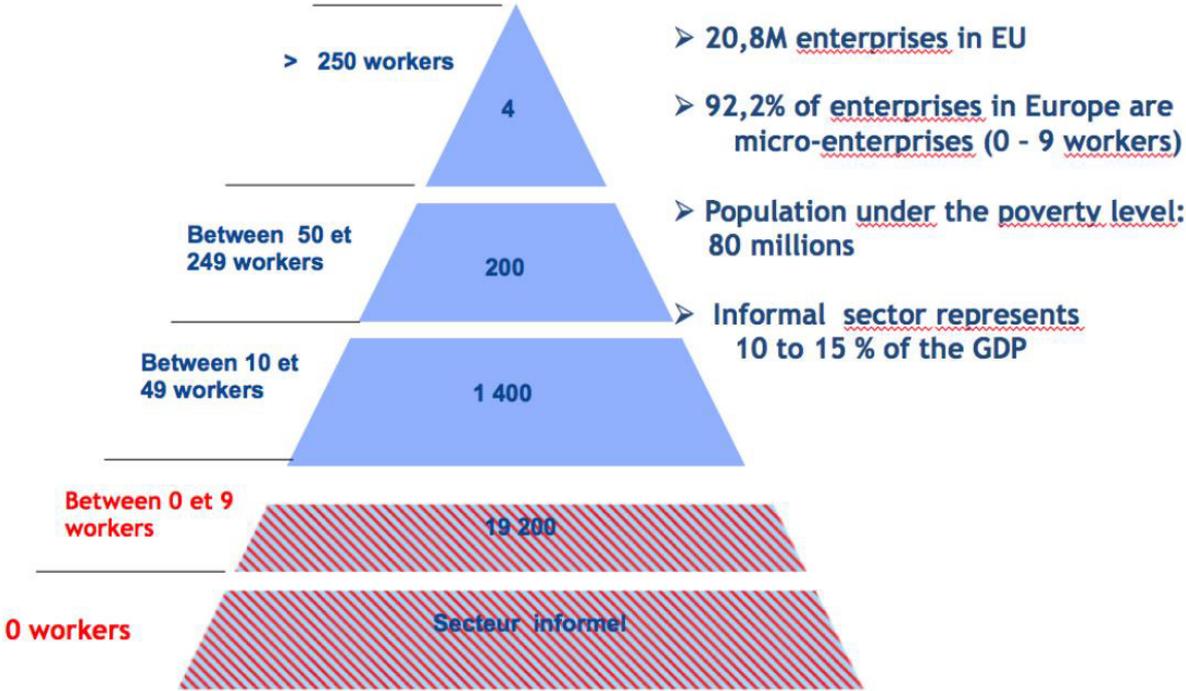
Micro-enterprises represent 93% of all companies in the European non-financial business sector, and they contribute to important shares of total economic activity and employment. In contrast, often, the smaller a company the more difficult its access to finance tends to be.

Table 1: EU definition of SME

	Employees	Turnover	Balance sheet total
Micro	<10	≤ EUR 2m	≤ EUR 2m
Small	<50	≤ EUR 10m	≤ EUR 10m
Medium-sized	<250	≤ EUR 50m	≤ EUR 43m

Source: European Commission (2016)

Figure 3: Distribution of enterprises in the European Union



Source: EMN

The relative size (or spread) of productivity differences between larger and smaller firms varies considerably across countries. In the United Kingdom for example micro manufacturing firms have about 60% the productivity level of large firms compared with around 20% in Hungary⁶.

Although there is no universally accepted definition of micro firms, the vast majority of definitions focus either on the number of employees and/or the turnover of the firm. The European Commission⁷ defines micro firms according to the number of employees, annual turnover or the balance sheet total. According to this definition, micro firms have less than 10 employees and have an annual turnover or a balance sheet total of no more than EUR 2m.

However, the definition of microcredit should be rather based on the type of client targeted (underserved population by the financial institutions), on the type of institution offering it (social purpose organizations characterized by their transparency, client protection and ability to report on their social performance results), and on the type of services offered, especially considering that the provision of accompanying services (non-financial services) is a key component of microfinance. Further, the definition should not be restricted on the basis of a limited amount⁸.

Micro companies typically operate as single owner-managed firms and the risk level they are willing to take could be high, they usually do not publish annual statements, and contracts with stakeholders are not publically available so information asymmetries and moral hazard problems are a complication when micro firms try to gain legitimacy and credibility.

European micro firms are more often rejected in the loan application process. Microenterprises indicate “insufficient collateral or guarantee”, “interest rates or price too high” and “too much paperwork” as the main barriers of obtaining finance.

⁶ OECD 2017

⁷ Commission Recommendation 2003/361/EC of 6 May 2003

⁸ EMN: Policy Note on Sector proposals to increase the impact of Microfinance in the EU 2015

Figure 4: Reasons for bank loans being not relevant (by enterprise size class, 2016)

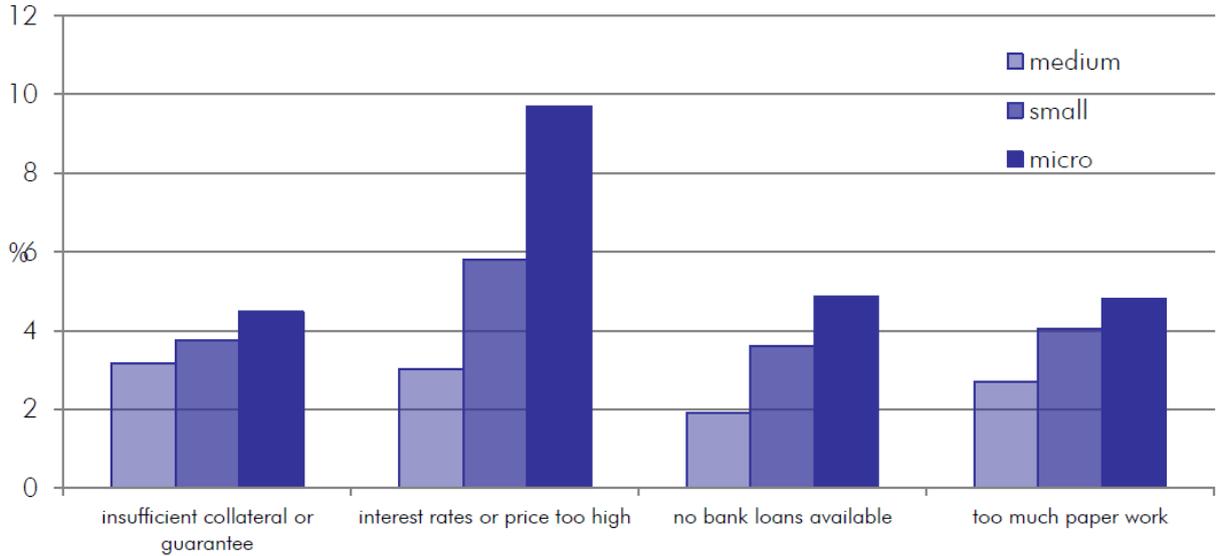
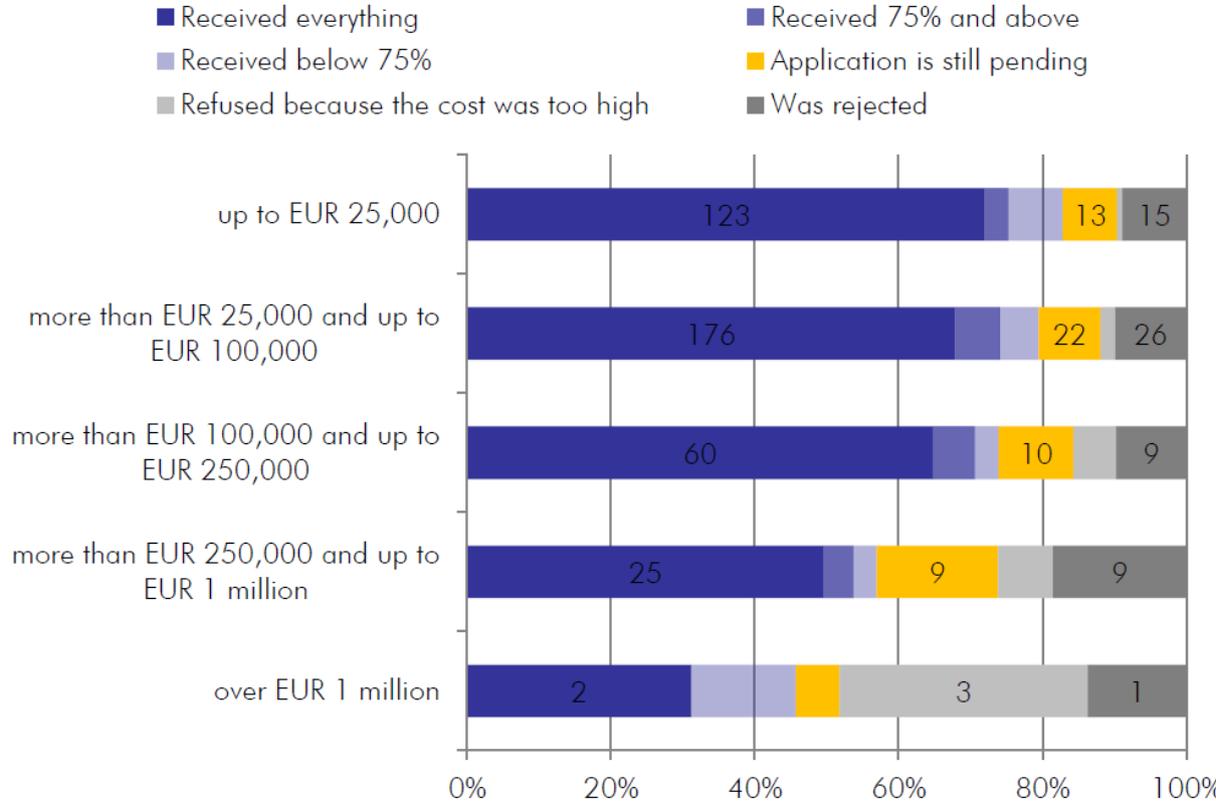


Figure 5: Application status of bank loans requested by microenterprises (by loan size, 2016)

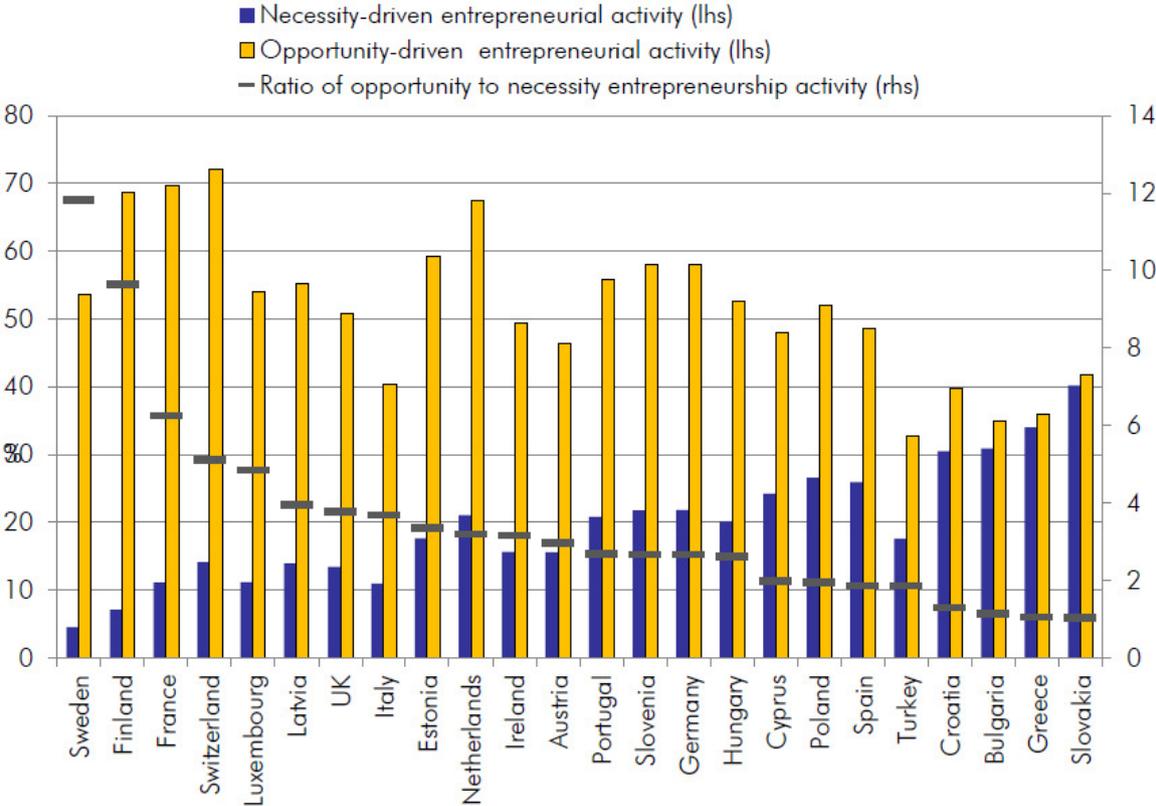


Source: ECB SAFE (2017)

In Europe, microfinance consists mainly of small loans (less than EUR 25,000) that are tailored to microenterprises. Microfinance could be considered as a social policy tool, as it serves businesses that are not commercially attractive for the mainstream financing providers, but nevertheless are able to create social value, or it can be seen as a business activity, which targets viable microenterprises that are financially excluded because the traditional credit market remains underdeveloped. The EC defines **microcredit** as “the extension of very small

loans (micro-loans) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable. It stands at the crossroads between economic and social preoccupations. It contributes to economic initiative and entrepreneurship, job creation and self-employment, the development of skills and active inclusion for people suffering disadvantages” (EU, *The European initiative to develop microcredit in support of growth and employment*, 2007). Microcredit can be useful even in the EU Member States also to encourage new businesses, self-employment and stimulate economic growth⁹.

Figure 6: Necessity-driven entrepreneurial rates (2016)

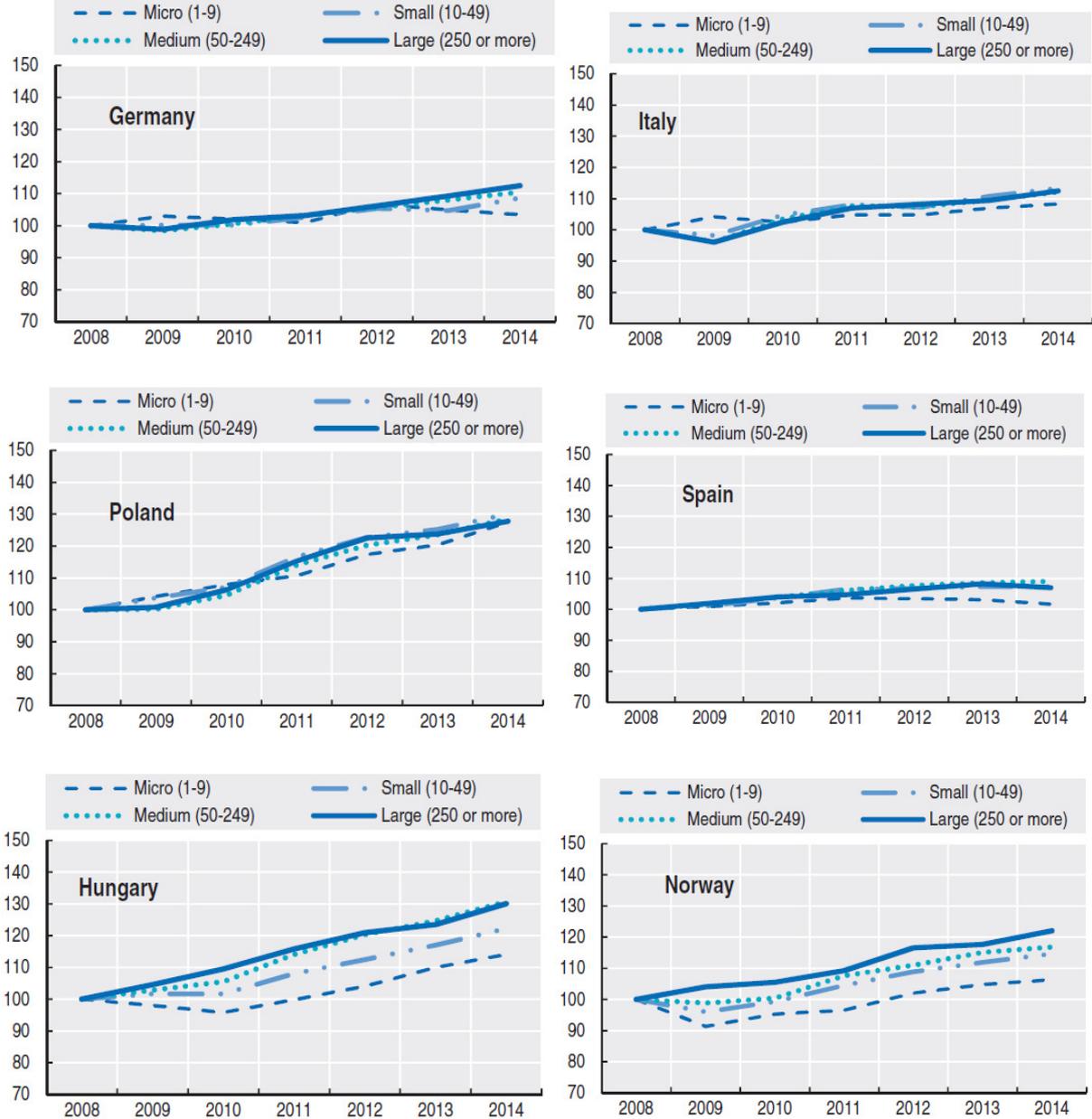


Source: GEM 2016/17 Global Report

However, wage differentials across firms typically align with labor productivity gaps, so large firms in the manufacturing sector are on average more productive and tend to pay higher wages than micro firms.

⁹ Nyikos: The Role of Financial Instruments in Improving Access to Finance; ESIF 2|2015

Figure 7: Growth in average compensation per employee by enterprise size class, manufacturing



Source: OECD 2017

Microfinance, characterized by a high degree of flexibility in its implementation, is a product that can be tailored to support the needs of aspiring entrepreneurs from disadvantaged labor market segments. Microfinance is the provision of basic financial services and products such as microcredit, micro-savings, micro-insurance and micro-leasing. Microfinance Institutions (MFIs) mainly focus on the financing of very small and small businesses (business microfinance) and low income or poor individuals (personal microfinance).

Figure 8: Share of MFIs by type of microloans offered (2015)



Source: EMN

Business and personal loan products, which are designed to meet different clients’ demands, differ greatly with regards to their terms and conditions. On average, personal microloans are much smaller in size, offered on shorter terms and are more expensive than business microloans.

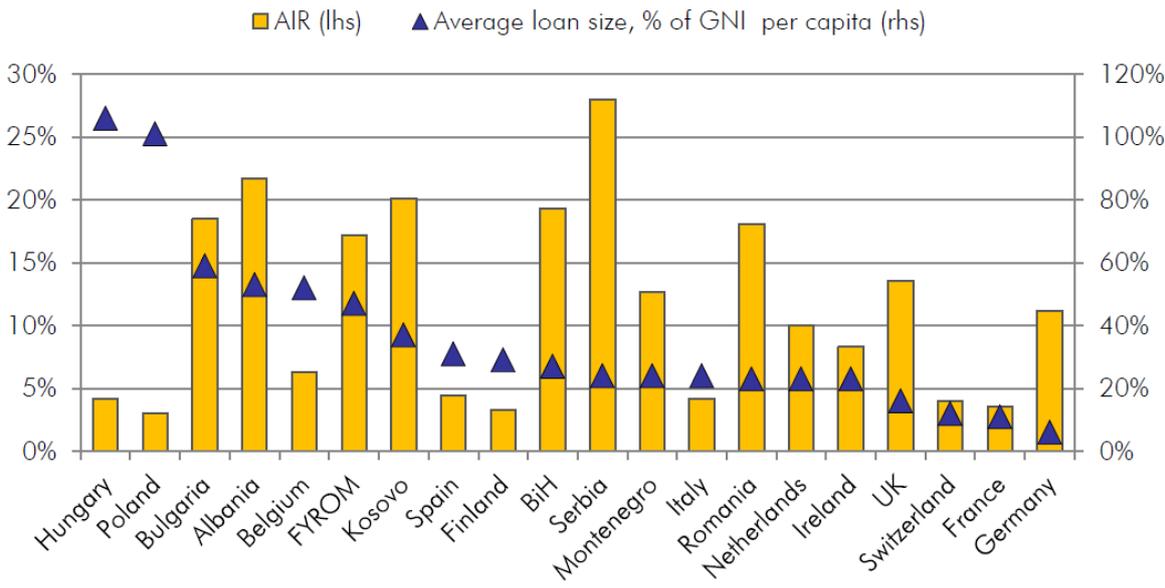
Figure 9: Average terms and conditions of microloans

	Business Microloans	Personal Microloans
Average outstanding loan size	€ 7,947	€ 1,697
Average microloan term	41 months	30 months
Average annual interest rate*	10.7%	19%

*does not include additional fees (Average fee: 2.5%)

Source: EMN

Figure 10: Microcredit conditions in Europe per 2015



Note: AIR is average interest rate, GNI is Gross National Income

Source: EIF based on data from EMN-MFC (2016)

The majority of the gross microloan portfolio (71%) is allocated for business microloans, because a large share of MFIs exclusively offers business products and EU support, and they finance income generating activities.

The driving force of the microfinance market is financial and social inclusion and generally target very small (new) businesses that lack any form of collateral or credit history. Microfinance has very positive effects on different policies that are especially sensitive in our societies:

1. Social Cohesion, since it offers more opportunities for employment
2. Economic Development, via wealth creation and small business financing
3. Public Finances. Encouraging the unemployed to start a business can save public money and it also generates additional revenue for public authorities.

3. Contributions to social inclusion and to micro-enterprise and self-employment development

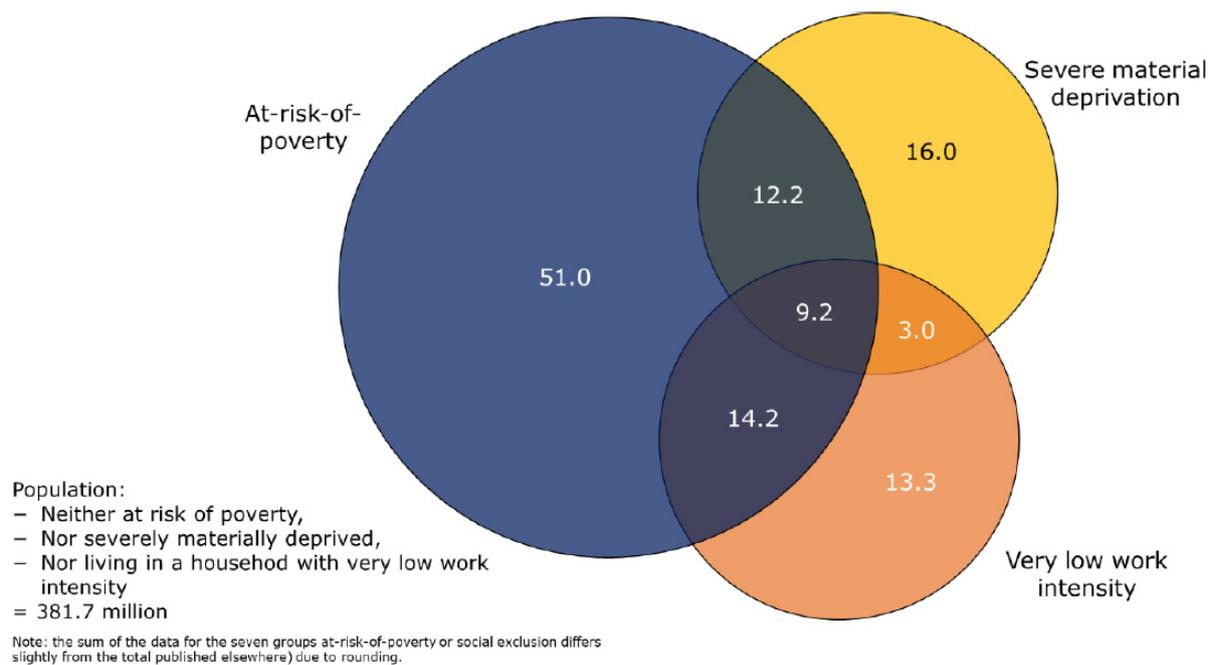
Social exclusion first appeared on the “EU scene” in a 1989 Council resolution on ‘combating social exclusion’¹⁰. Broader than the previously used term ‘poverty’, ‘social exclusion’ better underlines the multidimensionality of the problem it intends to describe. Since the mid-1990s, EU documents have referred to ‘poverty and social exclusion’ together. In 2002, Eurostat proposed a definition, recognizing its complexity and proposing a conceptual multifaceted framework considering the labor market position, the ascribed forms of stratification (gender/minority status), the traditional forms of stratification (social class, education and training), life history and capital, personal social capital and welfare resources.

Eurostat measures the risk of poverty or social exclusion as a condition where people experience a risk of poverty, or severe material deprivation, or live in households with very little work¹¹.

¹⁰ Social inclusion, as defined in the Joint report on social inclusion, is a process which ensures that those at risk of poverty and social exclusion gain the opportunities and resources necessary to participate fully in economic, social and cultural life and to enjoy a standard of living and well-being that is considered normal in the society in which they live. It ensures that they have greater participation in decision making which affects their lives and access to their fundamental rights. Commission of the European Communities, COM(2004)773 final.

¹¹ Eurostat Glossary, in [http://ec.europa.eu/eurostat/statisticsexplained/index.php/Glossary:At_risk_of_poverty_or_social_exclusion_\(ARPE\)](http://ec.europa.eu/eurostat/statisticsexplained/index.php/Glossary:At_risk_of_poverty_or_social_exclusion_(ARPE))

Figure 11: Category of people-at-risk of poverty and social exclusion, 2015



Source: Eurostat (online data code: ilc_pees01)

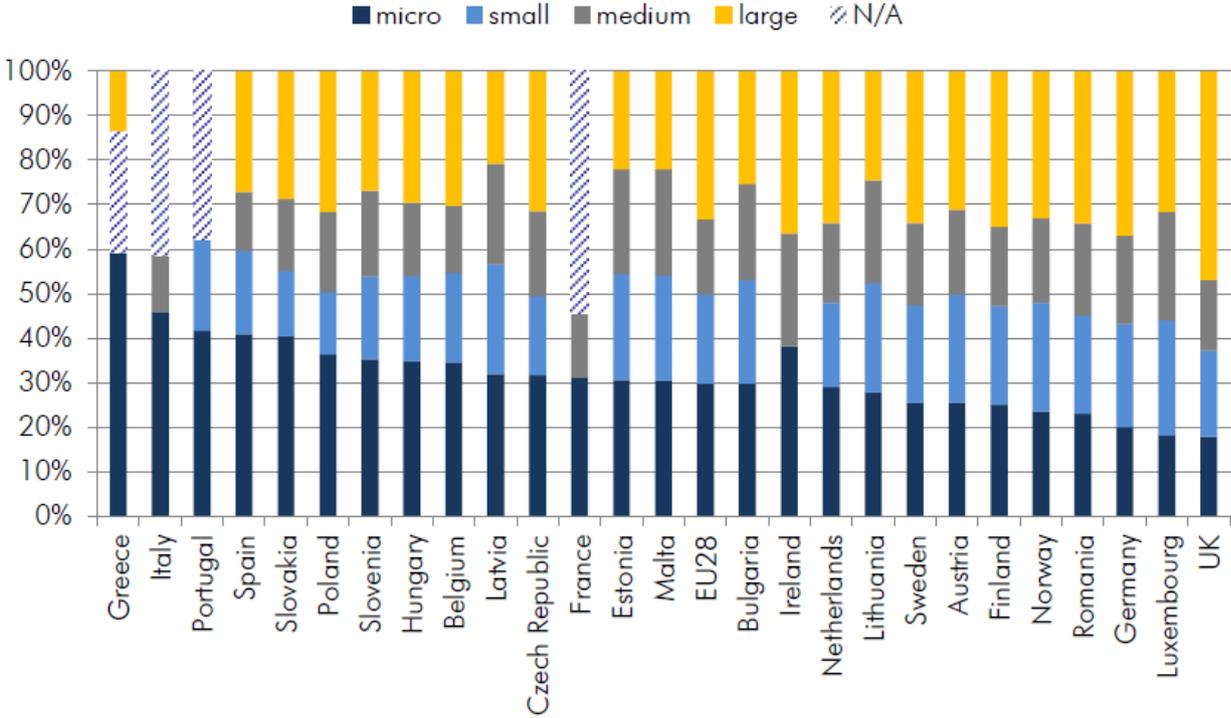
Micro lenders in Europe monitor jobs created and sustained. Usually the entrepreneur has a choice between operating a micro-enterprise as a self-employed individual or setting up one of several available types of corporate vehicles. With regard to self-employment and creation of microenterprises, the main obstacles are:

- the shortage of equity for enterprises registered as sole proprietorships and not incorporated as companies. It might be interesting to re-develop the system of silent partnerships that existed in most European countries in the first half of the 20th century, but is no longer applied. For persons emerging from unemployment, a start-up grant or subordinated loan at 0% may be a good solution,
- the complexity and weight of the administrative system and the unequal treatment of self-employment versus wage-earning,
- the difficulty of moving from a situation of unemployment or welfare payments to one of entrepreneurship, particularly as regards coverage of social security benefits and the corresponding charges, and
- the additional cost of training, coaching and business advisory services, especially for those who create their own enterprise after years of unemployment.

In most cases business development services are necessary and may be provided jointly by governmental agencies or specific authorities such as unemployment agencies.

Microenterprises are important contributors to employment and account for 30% of total employment¹². Micro-businesses seem to be relatively more important in countries with elevated unemployment levels. (e.g.: Spain, Portugal, Italy and Greece).

Figure 12: Relative employment share by microenterprises compared to other enterprise size classes (2014)

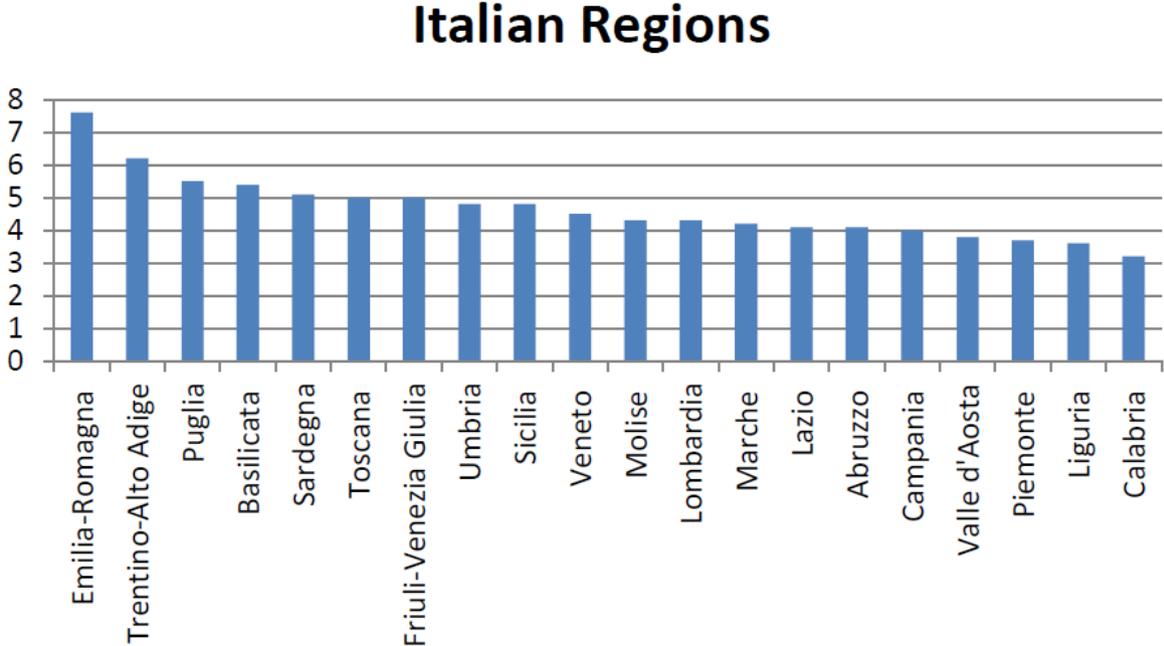


Source: Eurostat

In Italy 81% of the labor force is employed by SMEs (about half of this percentage is employed by a micro enterprise) while in the UK the percentage is around 46% and in Germany and France around 39%. In other words, if the role of SMEs is crucial for Europe, in Italy it becomes strategic¹³.

¹² European Commission, 2016
¹³ “L’Europa e le Piccole Medie Imprese, come rilanciare la sfida della competitività” – authors Andrea Renda and Giacomo Luchetta – Italian Presidency of the Council of Ministries – EU politics Departement

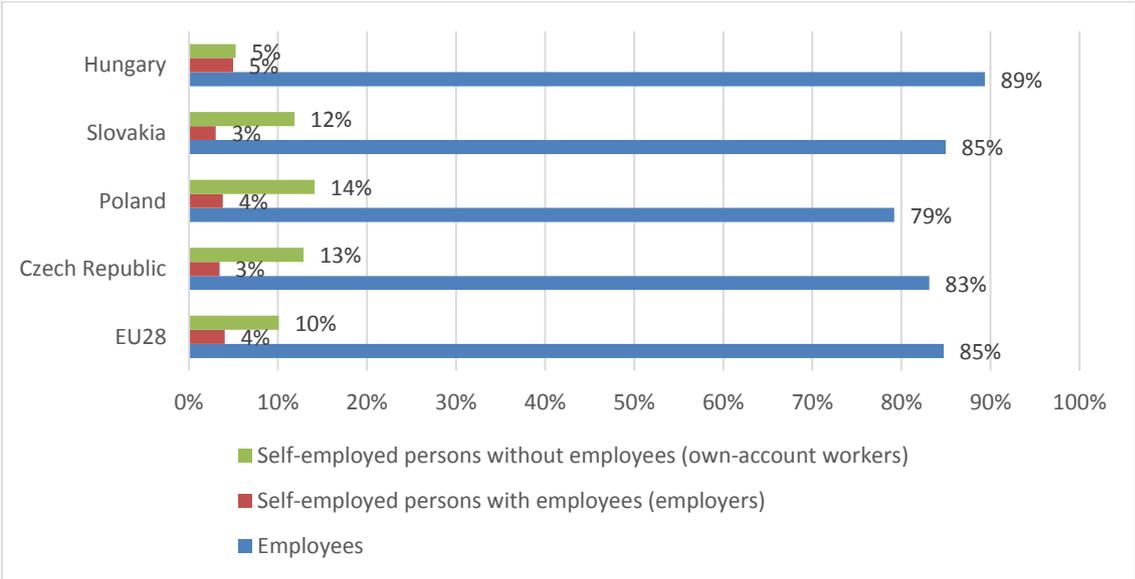
Figure 13: weight on the income of social cooperative enterprises on the total of regional economy for each Italian region



Source: Unioncamere

They also look at household income changes and business profitability. Monitoring changes in people’s lives, their access to services and inclusion in society can be more difficult and is undertaken less frequently. In terms of business survival rates, microcredit clients perform as well as other entrepreneurs. Most businesses supported create between 1 and 1.5 jobs in their first year.

Figure 14: Employment by professional status in V4 countries, 2015



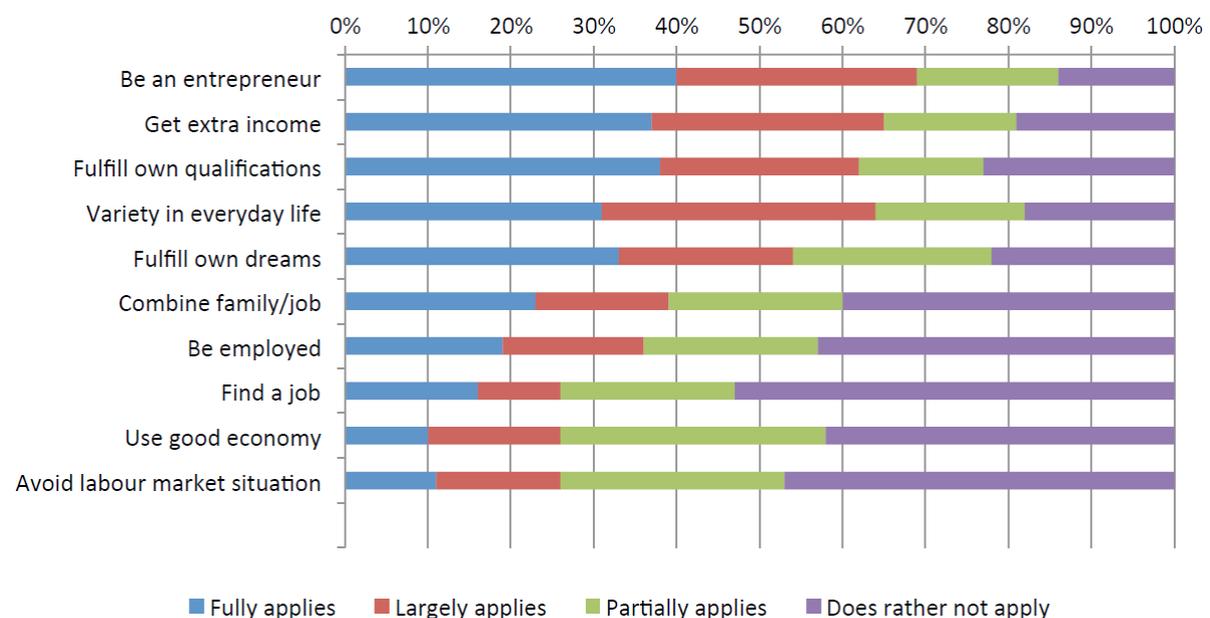
Source: Eurostat, Labour Force Survey

Figures do not add up to 100% because of non-respondents and family workers

Even when businesses fail, obtaining a microloan and running a business seems to improve clients' overall employment prospects. Owners of "failed" businesses sometimes sell their business and continue working for the new owner or find waged employment elsewhere. Organizations working with immigrants observe increased self-confidence with self-employment and in some cases family reunification thanks to improved income. Similarly, lenders working with women report gains in client self-confidence. Such results confirm the social value added of microcredit. These results also counterbalance the lack of sustainability and ongoing public sector support. Each job created represents reduced benefits payments and increased tax revenues.

In Germany there has been a significant decrease of necessity entrepreneurs. In 2015 in comparison to 2014 there were less full time self-employed, less necessity entrepreneurs and less start-ups which were set up in order to escape unemployment. Entrepreneurs do not think that Germany is a good location for self-employment; they say that reasons for that are mainly a lack of entrepreneurial knowledge transfer at school and the loan availability for entrepreneurs in Germany.

Figure 15: Motivation for being self-employed in Germany in 2015



Source: KfW – Gründungsmonitor 2016

Evaluation of impact – especially social impact – is extremely important. It is also directly linked to achieving sustainability. If microlenders can prove that it costs less to society to help a person create his own employment than to pay welfare benefits, then it will be acceptable to partly subsidize microlending

Legal conditions for microfinance

While it is the absence (or near absence) of formal regulation that has long given microfinance the necessary flexibility to develop as a successful financial inclusion tool, this situation has changed gradually over the recent decades. The academic literature¹⁴ provides a number of important justifications for the cause of this phenomenon, including the following: (1) the protection of the country's financial system and small depositors; (2) addressing the consequences of rapid growth and fast commercialization of the microfinance sector; (3) consumer protection and the fight against abusive interest rates; (4) the entry of new providers and credit delivery mechanisms in the microfinance sector; (5) lessons from the recent financial crisis; and (6) fraud and financial crimes prevention.

In general, however, it is considered that non-depository MFIs should not be subject to prudential regulation, unless the nature of their activities prescribes otherwise. Indeed, credit-only MFIs generally present less risk for the financial system and, considering the large amount of small MFIs, it would simply be impossible and too costly to oversee the whole industry. All MFIs should nonetheless be subject to basic consumer protection measures, although not necessarily in a regulatory way. Soft legislation may be more appropriate, especially for very small institutions.

1. EU level regulations

From the regulatory point of view, the situation is complex: the term microfinance currently refers to a varied set of activities having in common that they target a low-income population, but they can be offered by operators with very different legal forms (e.g. cooperatives, banks, foundations) and be subject to multiple laws (e.g. charity, banking, capital markets).

One starting point at the EU level is the European Initiative for Growth and Employment¹⁵, which proposes four axes of development:

- Improve the legal framework of microcredit
- Improve the legal framework of microenterprises
- Increase finance for microcredit
- Increase resources to strengthen business development services

Since the publication of the Initiative, the last two axes have experienced substantial progress with, on the one hand, the opening of Structural Funds to financial instruments (including microcredit) and establishment with the EIF of the Progress, and later, EaSI facilities.

¹⁴ See, for example, Peck Christen and Rosenberg (1999) and Chen, Rasmussen, and Reille, (2010)

¹⁵ published in 2007

However, with regard to the legal framework of microcredit and microenterprises, there has not been any improvement and before we could improve the legal conditions we should first define what microfinance really is. If the microfinance has been presented as a new and alternative form of banking, the discussion will therefore cover typical banking areas (banking services, payment services and, in part, investment services and financial markets).

Whereas the legislation concerning the banking sector is clear and harmonized to a certain extent by European banking law, the regulatory approach to microcredit provided by non-banks differs from country to country. For the bank model the factor determining whether an institution falls under the scope of banking legislation is the right to take deposits under European law. Many countries use this room for maneuver, allowing non-banks to operate credit-only activities without the need to have a banking license. For the non-bank institutions European law only forbids deposit-taking, but not lending activities per se. However, some Members States restrict almost all lending activities to banks.

For non-banks the fundamental question is whether existing legislation is suitable for operations. The absence of prudential regulation and supervision in itself poses no binding constraint to the development of microcredit.

It is important to take into account that a microfinance provider is usually not single minded, like traditional banks. It does not seek only profit maximization, but also to serve 'the poor'. This may justify a differentiated regulatory treatment that enables microfinance, and does not subject it to all the constraints imposed on traditional commercial banks. At the same time, though, social objectives must be pursued effectively and how to measure its effectiveness is a daunting task, but one that needs to be considered by regulators. Furthermore, regulation must be careful in limiting MFIs' permitted activities because this could endanger the objective of financial inclusion¹⁶.

In the regulation the key objectives are to allow various forms of funding for MFIs (e.g. donations, bank loans, crowdfunding, or microfinance investment vehicles – MIVs), and, at the same time, create safeguards to protect consumers, investors, and systemic stability. Microfinance products and service offerings aim to provide low-income people with tools to meet credit and saving needs as well as manage risk and efficiently execute transactions.

After the financial crisis, the EU has passed several groundbreaking reforms leading to a centralization of banking supervision and regulatory powers (e.g. the Banking Union in the euro-area) and moving to a maximum harmonization model, consequently presenting at the moment a quite homogenous bulk of norms in the financial area.

¹⁶ Eugenia Macchiavello : Microfinance and Financial Inclusion: The challenge of regulating alternative forms of finance (Routledge Research in Finance and Banking Law)

Table 2: Relevant banking rules and institutions subject to these

All EU Member States	Rules: Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR); Bank Recovery and Resolution Directive (BRRD); Deposit Guarantee Scheme Directive (DGSD); Institutions: European System of Financial Supervision (ESFS), including the European Banking Authority (EBA) and European Systemic Risk Board (ESRB)
Banking Union Member States	Rules: Single Supervisory Mechanism Regulation; Single Resolution Mechanism Regulation; Intergovernmental Agreement (IGA) on the Transfer and Mutualisation of Contributions to the Single Resolution Fund Institutions: ECB and NCAs (SSM); SRB and NCAs (SRM)
EEA/EFTA	The majority of relevant EU Single Market legislation applying to all EU members in the area of financial services has been adopted in the EEA agreement. However, the following important legislation has NOT been incorporated yet (although they are expected to be incorporated soon): EU Regulations on the European Supervisory Authorities (including the EBA); BRRD; and the last revisions of CRD/CRR and DGSD.
Switzerland	Bilateral agreements with the EU (there is one small bilateral agreement with Switzerland in financial services, specifically on non-life insurance)

Source: author compilation

There is a set of financial legislation known as the “Single Rulebook” that applies to all 28 EU member states. Although the substance of this body of law touches different parts of the financial field, three of the most important single-rulebook pieces are directly related to banking. These are the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR), the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Scheme Directive (DGSD), which lay down capital requirements for banks and create regulation to the prevention and management of bank failures, including a minimum level of protection for depositors.

Mainstream banks play a growing role in microfinance. If they adapt their strategy and at the same time use their significant capital resources, they are able to increase greatly the base of microcredit activities. When this happens non-bank institutions should remain alert to reaching the most excluded and difficult to reach part of the market with a more socially driven approach.

Efforts to facilitate information sharing are also underway at European level. The revised EU Payment Services Directive¹⁷ caters for the possibility of third-party payment service providers to have access to information that is kept at payment accounts. This will enable new and innovative players to have minimum account balances or overdraft limits, which are very valuable for assessing the creditworthiness of businesses, to compete for digital financial services alongside banks and other traditional payment service providers, including for the provision of finance. Monitoring movements of funds in and out of payment accounts and

¹⁷ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015L2366&from=EN>

watching maximum / minimum account balances or overdraft limits are very valuable for assessing the creditworthiness of businesses.

Box 1: Revised rules for payment services in the EU

SUMMARY OF:

[Directive \(EU\) 2015/2366 on EU-wide payment services](#)

WHAT IS THE AIM OF THE DIRECTIVE?

- It provides the legal foundation for the further development of a better integrated internal market for electronic payments within the EU.
- It puts in place comprehensive rules for payment services*, with the goal of making international payments (within the EU) as easy, efficient and secure as payments within a single country.
- It seeks to open up payment markets to new entrants leading to more competition, greater choice and better prices for consumers.
- It also provides the necessary legal platform for the Single Euro Payments Area ([SEPA](#)).

KEY POINTS

- The directive seeks to improve the existing EU rules for electronic payments. It takes into account emerging and innovative payment services, such as internet and mobile payments.
- The directive sets out rules concerning:
 - strict security requirements for electronic payments and the protection of consumers' financial data,
 - guaranteeing safe authentication and reducing the risk of fraud;
 - the transparency of conditions and information requirements for payment services;
 - the rights and obligations of users and providers of payment services.
- The directive is complemented by [Regulation \(EU\) 2015/751](#) which puts a cap on interchange fees charged between banks for card-based transactions. This is expected to drive down the costs for merchants in accepting consumer debit and credit cards.

Towards a better integrated EU payments market

The directive establishes a clear and comprehensive set of rules that will apply to existing and new providers of innovative payment services. These rules seek to ensure that these players can compete on equal terms, leading to greater efficiency, choice and transparency of payment services, while strengthening consumers' trust in a harmonised payments market.

Opening up the EU market to new services and providers

The directive also aims to open up the EU payment market to companies offering consumer- or business-oriented payment services based on access to information about the payment account, particularly:

- account information services which allow a payment service user to have an overview of their financial situation at any time, allowing users to better manage their personal finances;
- payment initiation services which allow consumers to pay via simple credit transfer for their online purchases, while providing merchants with the assurance that the payment has been initiated so that goods can be released or services provided without delay.

EU countries have to incorporate it into national law by 13 January 2018.

Source: EUR-Lex¹⁸

Two types of concerns related to fraud and financial crimes are predominant in connection with microfinance regulation:

(a) concerns about securities and abusive investment arrangements such as pyramid/ponzi schemes, and

(b) money laundering concerns.

In addressing these, it is generally agreed that the same rules should apply to MFIs as for other economic sectors.

2. National regulations

Basically, there are two models of institutions, which provide microcredit: banks and non-banks. The rules referring to the institutional model are complemented by rules concerning both types such as interest rate caps, tax and others, which can also have a decisive impact on microcredit.

EU financial law forbids deposit-taking simultaneously with lending without being regulated. Member States differ in the way that they allow lending: some of them take a stricter approach and many countries allow non-bank providers to work without having a specific regulation for the establishment of the legal entity of such institutions.

Save a few countries (such as Hungary, Italy from the partners) most EU jurisdictions do not have specific laws and regulations applicable to micro-enterprises. In the Member States where legislation regarding micro-enterprises has been enacted, specific rules apply only in pre-determined fields such as tax law (for example Italian legislation provide for a specific tax regime for micro-enterprises). In most European jurisdictions, the provision of microcredit is considered a financial activity and falls in the scope of general applicable laws on financing and providing loans. Some Members States restrict almost all lending activities to banks, such as Germany where microfinance institutions act as agents, while only banks or specific financial institutions can grant loans.

Of the EU Member States, 10 have a usury rule (namely Austria, Denmark, Finland, Germany, Hungary, Italy, Poland, Romania, Spain and Sweden), while such provisions are not applicable

¹⁸ <http://eur-lex.europa.eu/legal-content/EN/LSU/?uri=CELEX:32015L2366>

in the remainder of the EU jurisdictions. Of the countries prohibiting usury, only Germany, Italy and Poland have defined the term with reference to a specific figure, usually a percentage uplift or multiple of the market interest rate or a rate fixed by public authorities. In addition, interest rate caps in the context of microcredit are operated in Poland, where microcredit is considered to be a personal credit.

There is no discernible European-wide trend for tax incentives aimed specifically at microcredit. Both micro-enterprises and microfinance institutions may be eligible for beneficial tax treatment under general tax legislation. For instance: start-ups and/or SMEs benefit from special tax rules in several Member States including the Germany, Italy, Spain), tax deductions are available to the self-employed in e.g. Italy; investments in start-ups benefit from certain tax benefits in e.g. Germany, special tax regimes apply to non-profit organizations in e.g. Spain.

The guarantee schemes may be public, private or mutual and may operate on a national/federal or regional/federate level. In Member States where microfinance institutions operate, loans provided by such institutions may be guaranteed through state-sponsored schemes, schemes promoted by local authorities, mutual arrangements among microfinance entities or bank-supported institutions.

Table 3: Overview over the most important features in the different regulatory systems

Country	Special regulation	Non-bank microfinance institutions	Tax incentives	Guarantee schemes
Croatia				
Germany				
Hungary		X		X
Italy				
Poland				
Spain				
Norway				

Source: author compilation

In **Hungary** the Act on credit institutions and financial enterprises¹⁹ provides the general legal framework for crediting activities including microcredits. With one exception all existing and newly established organizations should comply with the requirements set by this Act. The Act makes a difference between credit institutions and financial enterprises. The latter have less strict entry and operational requirements but the Act limits their service portfolio and they cannot collect savings. Microfinance activities can be provided both by credit institutions and by financial enterprises. However, special Hungarian microfinancing institutions – Hungarian Foundation for Small Businesses and 20 local enterprise agencies operating in the form of foundations - do NOT fall under the scope of the aforementioned Act. Notwithstanding this,

¹⁹ No. 237 of 2013

the Hungarian legal framework for microfinance provision is well established and provides clear rules to follow for the actors concerned. Concerning the supervision activities the most important actor is the Central Bank of Hungary that acts as the supervisory body for credit institutions and financial enterprises since 2013 when the Central Bank of Hungary and the Hungarian Financial Supervisory Authority was merged. Beyond that the Hungarian Authority for Consumer Protection should be mentioned that might also have relevance from a consumer protection point of view in the case of microfinance institutions.

In **Italy**, with policy and legislative developments at the EU level, the government has introduced specific rules²⁰ for microfinance provision in 2010, thus updating the applicable Consolidated Law on Banking²¹. In 2014, the Ministry of Economy and Finances has regulated the implementation of the new provisions in the field through the adoption of a specific Decree²², which provides the following main rules for microcredit:

- microcredit for entrepreneurial activities (in order to start a new business and/or facilitate labour market access): applicable to individuals and specific categories of companies, ceiling of € 25.000 per beneficiary (in certain conditions, this limit may be increased by €10,000), maximum duration 7 years (up to 10 years in specific cases),
- microcredit aiming at promoting social and financial inclusion projects: applicable to specific individuals , ceiling of € 10,000 per beneficiary, maximum duration of five years,
- no collaterals,
- eligible expenditure: e.g. purchase of goods and services, including insurance policies, salaries, training costs (also university or postgraduate),
- delivery of support services (e.g. project idea development, training, marketing, advisory).

In **Germany** the regulatory framework for providing loans is regulated by the Banking Act²³. Professional provision of loans asks for a banking license and therefore, loans can only be provided by banks. The national banking supervision authority BaFin²⁴ supervises and controls all activities of the financial market, only “significant” banks are supervised by European Central Bank. A special regulation for microcredit provision does not exist. However, in the past some German MFIs, like Goldrausch e.V. in Berlin, asked BaFin for a special permit (exemption), which was granted on the condition that loans were provided at an interest rate of 0% and serve a specific purpose, such as supporting a clearly defined disadvantage target group. Also the programme was limited to a portfolio size of 1 million Euros. Goldrausch provided loans and non-financial services, like consultancy, to female entrepreneurs in Berlin. Goldrausch’s staff was financed with public support from the City of Berlin. All non-banking financial institutions interested in providing microcredit need a special permit from BaFin to

²⁰ Legislative Decree D.lgs. n. 141/2010

²¹ D.Lgs. n. 385/1993, art. 111 and 113

²² n. 176, 17/10/2014

²³ Kreditwesengesetz KWG

²⁴ Bundesanstalt für Finanzdienstleistungsaufsicht

disburse loans directly. Since the situation described above was not satisfactory and access to finance for start-ups and SMEs was extremely difficult, DMI (Deutsches Mikrofinanz Institut) developed the 'Trust-based Partnership Model for Microcredit Provision'. In its core, the Trust-based Partnership Model solves the problem of providing loans to target groups, which banks do not want to or cannot serve because this financial service is not profitable. Today, the public and third sector stakeholders in social finance are seeking to develop a strategy, to commit key actors and to find suitable and feasible procedures to support not only micro and small enterprises and business starters but also social enterprises. The latter also experience harsh difficulties in accessing loans from banks.

Spain does not have a specific microfinance law. Because of this legislative gap, the financial sector (banks and saving banks) used to lead the sector, with NGOs playing a subordinate role, providing the relative social activities: for this reason, many programmes were often not sufficiently focused on the social dimension of microfinance. After the collapse of the savings banks in 2010-2011, microcredit activity stopped almost entirely, with only MicroBank and some NGOs continuing with minor activity. The current legal and regulatory framework is not appropriate for the development of the microfinance sector, which is currently characterized by a limited offer of microfinance financial products (almost limited to microcredits only), lack of coordination and little sustainability.

Also in **Poland** non-bank financial enterprises, as opposed to traditional banks, are not subject to any prudential regulations concerning capital and liquidity requirements. The basis for the functioning of non-bank loan companies and legal regulation shaping the form of their operation is provided for in the Business Freedom Act of 2 July 2004, Act of 15 September 2000 - Code of Commercial Companies, and the Act of 23 April 1964 - Civil Code. Such companies are required to comply with legal acts which specifically regulate activity consisting in the provision of financial services, including the granting of consumer credits, as well as with acts that do not concern solely financial services but pertain to consumer protection in its broad sense, as well as with legal provisions which establish supervision over compliance with consumer rights and penalize their violation

The legislative framework for financing SMEs and microfinance in **Croatia** is made up by the following laws: Law on HBOR²⁵; Law on Investment Funds²⁶; Law on Credit Unions²⁷; Law on Credit Institutions²⁸; Law on Alternative Investment Funds²⁹.

²⁵ NN 138/06, 25/13

²⁶ NN 150/05

²⁷ NN 141/06, 25/09, 90/11

²⁸ NN 159/13, 19/15, 102/15

²⁹ NN 16/13, 143/14

3. Pricing – competition rules

The most important strategic issues for the sector are related to funding and sustainability. Funding operational costs, in particular, is a significant challenge for lenders.

Reaching clients is not easy in the European context. Organizations need to have the capacity and resources to develop proper strategies, methodologies, appropriate financial products and to use adequate monitoring and evaluation tools. Microlenders also need to develop and improve efficiency and cost recovery strategies that include greater attention to deal flow, interest rates, fees, guarantee arrangements and portfolio performance. Efforts should be made to improve operational performance in order to reduce cost and be more efficient. Funding operational costs remain the primary limit to sector development identified by lenders in all of Europe. The regulatory environment, institutional capacity and access to funds for loan capital are also significant challenges.

On the other hand, for the pricing state aid issues could be also relevant, especially if there is some grant element involved.

Regarding State aid rules, the envisaged FI should be either:

- **Market-conform** (pari passu)³⁰; or
- covered by the **de minimis regulation**³¹ (specific de minimis rules for primary production in agriculture and for fishery apply), which means that the support is presumed not to affect competition and trade between MS; or
- covered by the **block exemption regulation** (GBER³², ABER³³) which defines categories of state aid that are presumed to be compatible and hence are exempt from the notification requirement; or
- if the envisaged FI is set up as an **off-the-shelf instrument**; it is exempt from notification procedures, since the design of such instruments ensures that they do not need to be notified to the Commission; or
- if not covered by a block exemption regulation and hence **requires a state aid notification** under the appropriate state aid rules as well as approval by the Commission before implementation so as to confirm the compatibility of the aid with the internal market.

³⁰ When:

- The amounts are similar and on similar terms.
- The private investment is not nominal/marginal.
- The investments take place at the same time.
- The private investors derive no extra advantage [an advantage outside the framework of the investment].
- The private investors do not have other exposure/liability in the company in which they invest.

³¹ Commission Regulation (EU) No 1407/2013.

³² Commission Regulation (EU) No 651/2014

³³ Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agricultural and forestry sectors and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union.

The logic behind using public sources in FIs is that economically viable but commercially not bankable projects can receive finance due to having a development purpose. Basically if the project could receive funding from the market, there is no need for development support (market distortion and crowding out effect) or microfinance. However, if the conditions of the market finance differ too much from the FIs' financing conditions, that means that state aid is granted, so the measure needs to be in line with some state aid legal basis. Other difficulty is if there is not market finance at all.

The whole logic from another point of view: defaults and other failures to pay back financial instruments are unavoidable. However, based on cohesion policy rules the institutional system tries to avoid irregularities and failures, and the more risk-averse public authorities and financial intermediaries are, the more closely they tend to behave like private investors who care predominantly about their financial returns³⁴. As a result, they provide finance to businesses and public organizations that could also obtain funding from the markets, so the result is again market distortion and a crowding out effect. In addition, the conditions when default is not due to some irregularity have to be clarified.

Public investment is free of state aid when it is made at the same time and on equal terms with investments by private investors. The first question is whether the public investment is really needed or not (again market distortion and crowding out effect or not). The second remark is that the share of the private investor(s) should be substantial (min. 30%) for the *pari passu* status.

4. European Code of Conduct

The European microcredit market is growing and is still heterogeneous due to the disparity of the legal and institutional frameworks in the Member States and the diversity of the microcredit providers. As a consequence, lending practices in microcredit vary considerably depending on the type of institution providing micro loans, its legal setup, the environment in which it operates and its own ability to apply sound and efficient management procedures.

The European Commission designed a voluntary "European Code of Good Conduct for Microcredit Provision". The Code has become a pre-condition for accessing assistance from EaSI Technical Assistance and EaSI Financial Instruments.

The objective of the Code is to set out good practice guidelines that will better enable the sector to face the challenges of accessing long-term finance. The aim is to provide a document benefiting funders, investors, customers, owners, regulators and partner organizations. The Code is divided into five indexed sections comprising several clauses:

- *Customer and Investor Relations*: This section covers obligations of microcredit providers towards customers and investors, and rights of customers and investors;

³⁴ Funding only bankable projects that have sufficient collateral, future cash flows or adequate risk profiles

- *Governance*: This section covers standards for both management and the board of microcredit providers;
- *Risk management*: This section details common approaches and procedures for managing risk;
- *Reporting Standards*: This section details which indicators, including those on social aspects, microcredit providers must collect, report and disclose;
- *Management Information Systems*: This section details common standards for management information systems;

The Code of Good Conduct is primarily addressed to non-bank microcredit providers. For customers, it is a tool to ensure that they are treated in a fair and ethical way. For investors and funders, it ensures that the sector operates with transparent and pan-EU reporting standards. For regulators, it gives reassurance that the sector operates according to sound business practices and principles and that it is well governed.

Organizations that already comply with the banking legislation and the Capital Requirement Directive and are supervised accordingly, such as banks, savings banks or cooperative banks, will nevertheless have the possibility to endorse the principles of the Code.

The pilot phase testing the European Code of Good Conduct for microcredit provision with some microcredit providers has come to an end in April 2017. This test phase has allowed some conclusions to be drawn in order to better meet the needs of the microcredit market in Europe.

Sources in microfinance

Microfinance institutions predominantly receive their funding from public sources at national or regional level and various European sources (such as the European Structural and Investment Funds, European Investment Fund).

International aid has also been utilized by microfinance institutions in Eastern Europe (e.g. USAID in Slovakia and the UNDP in Bulgaria), although such funding disappeared with the integration of these countries into the EU.

1. Public funds - EU sources

Social and financial inclusion generate economic and social returns by reducing unemployment, empowering citizens and alleviating the pressure on welfare subsidies. The EU stance is to make public intervention conditional upon “additionality”, i.e. adding EU money to private, regional and states funds in order to create a sustainable market in the long run. Balancing social purpose and financial sustainability is the great challenge of microfinance. In general, microfinance involves a higher proportion of management costs and higher risk, so interest rates are higher. If we exclude commercial banks, the majority of the intermediaries share the following features: social purpose as main goal; provide credit at the

local level; have capacity to offer adaptable financial services, and have qualified expertise for providing non-financial services like advice and training. Non-bank intermediaries generally operate more in markets with low financial service penetration and limited public or third party support.³⁵

The European Union supports entrepreneurs and businesses with a wide range of EU programmes providing financing through local financial institutions. The Access2finance portal³⁶ provides complete and up-to-date information on how businesses can access EU financial instruments from various EU programmes in each country and language. Every year the EU supports more than 200,000 businesses. This website allows access to over €100 billion of finance from various EU programmes, such as COSME Programme, InnovFin Programme (Horizon 2020), Programme for Employment and Social Innovation, European Structural and Investment Funds and European Investment Bank and European Investment Fund.

The EU set up a microfinance facility for employment to offer a new chance to the unemployed and open the road to entrepreneurship for the disadvantaged groups, including the young. The European Progress Microfinance Facility (Progress Microfinance) was launched in 2010 and managed by EIF in the 2007-2013 programming period and funded by the EC and the European Investment Bank.

This facility is now included in the new 2014-2020 programme for EaSI, which is a European-level financing instrument managed directly by the European Commission to support employment, social policy and labor mobility across the EU. The concept of social innovation is at the heart of EaSI.

The budget is allocated to three broad projects:

- PROGRESS (Programme for Employment and Social Solidarity): Around 550 million Euros (61% of the total budget) will support activities with a strong Europe-wide dimension such as comparable analysis, mutual learning and exchanges of practices in the field of employment and social policies
- EURES: Around 160 million Euros (18% of the budget) will be dedicated to the EURES network that provides information and advice to job seekers wishing to work in another EU country. EaSI will finance core activities at EU level, while the national activities can receive funding from the ESF.
- Progress Microfinance: Around 200 million Euros (21% of the budget) will extend the support given to microcredit providers and institutions in order to make more loans available, and will help to develop the social investment market and access to financing for social enterprises.

³⁵ Bruhn-Leon, Eriksson and Kraemer-Eis 2012

³⁶ www.access2finance.eu/

EIF is managing the EaSI Guarantee Financial Instrument which is specifically dedicated to microfinance and social entrepreneurship finance.

This instrument has two main objectives:

- increase the availability and accessibility of microfinance for vulnerable groups and micro-enterprises;
- increase access to finance for social enterprises.

EIF does not provide any type of finance to micro-entrepreneurs or social enterprises directly. Through the EaSI Guarantee Financial Instrument, EIF offers guarantees and counter-guarantees to financial intermediaries selected by EIF. Thanks to the risk-sharing mechanism between the financial intermediaries and the EC, the EaSI Guarantee enables selected microcredit providers and social enterprises investors to expand the range of enterprises they can finance, facilitating access to finance for target groups who might be having difficulties in accessing the conventional credit market.

The using of the cohesion policy sources for microcredit is not a completely new phenomenon. It started already in the 2000-2006 programming period when several initiatives were launched (e.g. EQUAL MFI in Germany, specific of Global Grants in Spain, regional ESF programme in Tuscany). In the 2007-2013 period several Member States set up microcredit schemes using financial instruments from the start; but others have had to introduce them following the economic and financial crisis. The JEREMIE initiative (Joint European Resources for Micro to Medium Enterprise) tapped into structural funds to promote the use of financial engineering instruments and improve access to finance for SMEs. Several Member States – also Hungary - have also taken this opportunity to launch microcredit schemes at national and regional level within their operational programmes. The Member States have followed 2 main different organizational models: some of them used national development organizations (Hungarian institutional model; Germany: Mikrokreditfonds by Germany GLS bank; Spain: Microcredit Initiative INCYDE³⁷ Founded as a Chamber of Commerce initiative) and several MAs have called upon the expertise of the EIF to manage these instruments.

Financial instruments have been used for delivering investments for Structural Funds since the 1994-1999 programming period. Their relative importance has increased during the programming period 2007-2013, and in the light of the current economic situation and the increasing scarcity of public resources, they seem to be one of the key tools to achieve the strategic objective in this programming , and according to several expert and policymakers are expected to be the future of the cohesion policy. Financial instruments (FI)³⁸ have attracted interest because of its revolving character meaning that FIs invest on a repayable basis, as

³⁷ Instituto Cameral para la Creación y Desarrollo de la Empresa

³⁸ Financial instruments are the term used in preference to financial engineering instrument for the next programming period.

opposed to grants, which are non-repayable investments³⁹. Their use has been promoted because of the added value of revolving instruments compared to that of grants in terms of the efficiency of use of public resources. The revolving nature allows for a much greater efficiency in the allocation of public capital and the long-term sustainability of public investment. Secondly, by unlocking other public sector funding and private sector resources through co-financing and co-investment, FIs aim to increase the overall capital available. Additionally, the private sector participation enables policymakers to make use of private sector skills and expertise in areas such as identifying investment, decision-making, management of commercial operations and the ability to achieve returns. Repayable forms of finance can also act as incentive for better quality investments as investments need to be economically viable to be able to repay the assistance provided. Targeting projects with potential economic viability, financial instruments provide support for investments by way of loans, guarantees, equity and other risk-bearing mechanisms, possibly combined with technical support, interest rate subsidies or guarantee fee subsidies within the same operation.

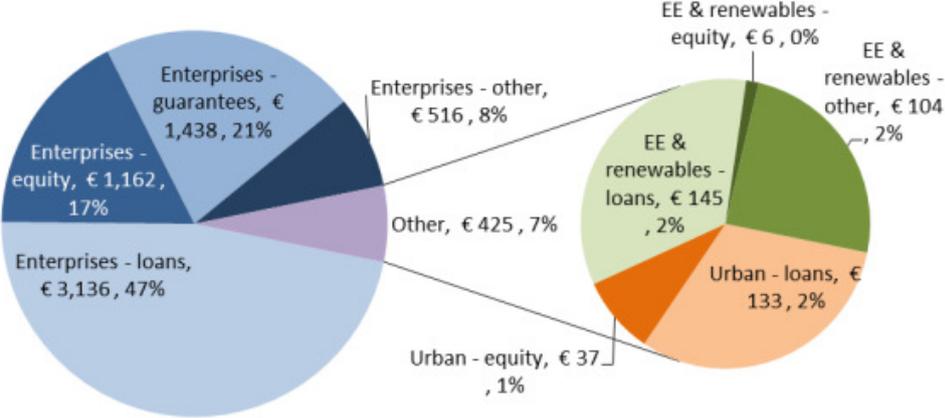
Table 4: FIs by specific fund-type classification

Form	Description
Equity	Direct investment in the share capital of an undertaking. Involves ownership and capacity to influence governance of the investee firm. May cover seed, start-up and expansion capital. May also be known as venture capital, which is a subset of private equity, strictly defined. Can take various forms, with different levels of risk. Risks for investors may be high (depending on security); so may be returns (depending on performance).
Loan	Borrowing to finance businesses or projects over a period of time and at an agreed rate of return, typically on the basis of the quality of cash flow and strength of the underlying assets; may be on commercial or subsidized terms.
Guarantee	Underwriting funds to provide security for firms that are unable to obtain financing otherwise; may cover all or part of the capital. May take the form of guarantees on bank loans, micro-credit or equity. May involve a fee or higher interest rate for the borrower.

Source: Michie and Wishlade (2011)

³⁹ FIs are defined also in Financial Regulation as measures of “financial support provided from the budget in order to address one or more specific policy objectives by way of loans, guarantees, equity or quasi-equity investments or participations, or other risk-bearing instruments, possibly combined with grants”.

Figure 16: Sums disbursed to final recipients by type of FI and target (€m and % of total)



Source: European Commission Summary Report 2014.

The new regulation puts increasing importance on the use of FIs, which are to become more important in 2014-2020. The Investment Plan for Europe strongly encourages the use of financial instruments instead of traditional grants in ESIF funding. However, it should be also noted that a shift from traditional financing to more innovative instruments is not advisable in all policy areas; it should not be used for projects that can only benefit from the use of grants, which are particularly important for less developed regions.

The crucial criterion for the evaluation of a financial instrument’s added value is its ability to fill the funding gaps and compensate for the market failures that were identified in the market analysis. “The size of the market of a public sector led FI is the amount of finance that could be extended by the fund given any level of return sought, but only in those parts of the market in which the private sector will not invest for reasons of market failure. It is therefore highly dependent on the rate of return sought and the specific investment and pricing strategy which a fund may adopt (...) [Correspondingly] the size of the market for a new fund is subject to a large degree of uncertainty (...) Evidence of the finance gap and the optimum size of FIs should be drawn from a variety of sources, including, very importantly, the insight gained from operating these funds in the same or similar markets”⁴⁰.

⁴⁰ EIB (2015), Using Financial Instruments for SMEs in England in the 2014-2020 Programming Period - A study in support of the ex-ante assessment for the deployment of EU resources,

2. Private sources

European MFIs can seldom operate without receiving subsidies or public or private investments. That is explained by local regulations that mandate especially low caps on interest rates⁴¹. These institutions also record a larger share of outstanding balances, since their borrowing methodology must focus on individuals (instead of groups). However, some institutions can benefit from insurance policies that cover a large portion of these risks (e.g.: EaSI program). With these limitations several commercial banks investigating for themselves, and some are entering the microfinance market because they see sustainable profit and growth opportunities, and/or finance MFIs and playing a role as a social and civic player in its domestic markets.

Some banks enter the market directly by expanding their retail operations to reach the “micro-level” by creating an internal unit or launching a separate company, such as a service company or specialized financial institution. Others take an indirect approach by working with existing microfinance providers.

Provide services directly through:

- an internal microfinance unit, or
- a specialized financial institution, or
- a microfinance service company.

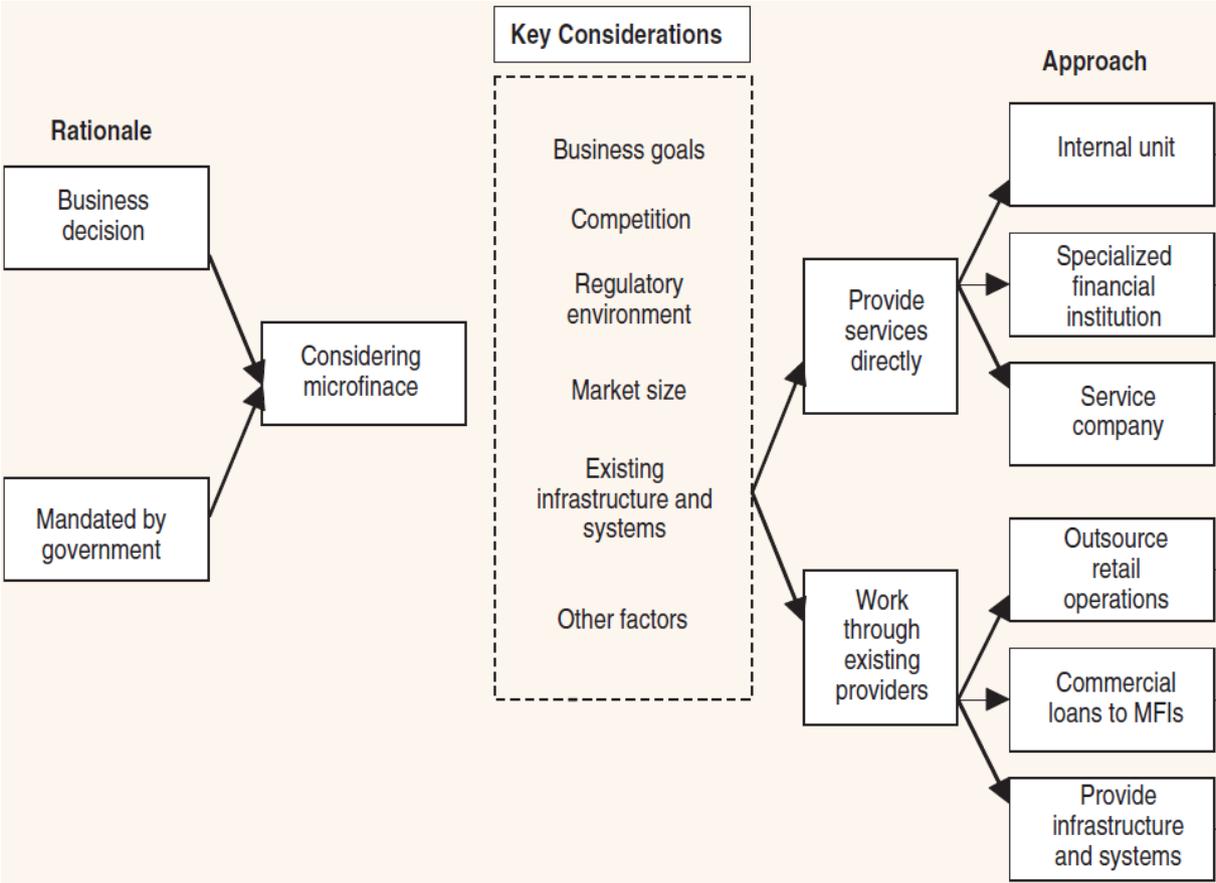
Work through existing providers by:

- outsourcing retail operations, or
- providing commercial loans to MFIs, or
- providing infrastructure and systems.

⁴¹ MFIs operating in non-EU countries ensure the continuity of their business by charging higher interest rates, which still remain below maximum borrowing rates. In general, they have a lower level of outstanding balances.

Each approach has its particular rationale, risk profile, success factors, and costs.

Figure 17: Decision Tree for Commercial Banks in Microfinance



Source:

The bank may delegate credit decisions to the MFI if the MFI has a history of maintaining a high quality loan portfolio on its own, or the bank may structure a joint review process. However, this model requires that the bank and MFI share risks and incentives to maintain high portfolio quality. Hence, the bank may ask the MFI to finance a portion of the microfinance loan portfolio or provide a first loss guarantee on a portion.

Conclusion

The microfinance being provided in the industrialized world differs from the original concept of microfinance as applied in the developing world. Within the EU, there should be as clear as possible a separation between small loans that can be supplied by a bank to bankable borrowers, and those cases that should indeed be handled by a MFI or development bank (the non-bankable segment of the market).

Nevertheless, it should be recognized that in some markets banks are providing, or supporting, microfinance services to the non-bankable sector as well. In these cases, their activities are motivated by their own CSR or financial inclusion objectives, and/or by the benefit of collaborating with public bodies through public-private partnerships. In the longer run, these activities may allow some borrowers to migrate from the non-bankable to the bankable.

Whatever the pattern of the microfinance business in a market, it is important to avoid confusion between the bankable and non-bankable kinds of business. Each type has its distinct objectives, risk profiles, and rewards, which should be as transparent as possible.

In the microfinance the impact of the financial activity, the fulfilment of the social mission/social outreach is very important. It is stated in the European Code of Good Conduct for Microcredit Provision too. Establishment of the indicators serving the purpose of measuring the social goals is crucial. The MFIs have to achieve results with its activities in the social field as well, they have to:

- contribute to the sustainable development of the clients, their families and communities (improve their financial situation and abilities),
- promote gender equality,
- promote entrepreneurship among career-starters,
- find out and meet the needs and capacities of the targeted clients better in order to improve entrepreneurial wealth.

The main goal of microfinance should be the promotion of the wealth of the entrepreneurs and their families.

Györgyi Nyikos

Summary

By and large, the primary lesson is that the development of any instrument for the handling of social issues should always start with the analysis of the relevant problem followed by the selection of the instruments most suited to the envisaged solution of the problem.

In our case, the main problem present even in developed countries is the large number of individuals who are unable to obtain a loan in the bank sector owing to the fact that they intend to support themselves and their families via self-employment.

The underlying reasons are the high risk associated with the fulfilment of these loan requests and the fact that banks tend not to realize profit on small amount loans.

One way to address the problem is to make microcredits more accessible to such individuals, who are otherwise excluded from the financial services of banks.

Bodies specializing in providing small amount loans to such individuals are referred to as microfinancing organizations.

It follows that the development and promotion of the microfinancing sector might provide a solution to the above social problem.

However, this is not entirely the case as the microfinancing sector is far from uniform.

It consists of two distinct branches with different guidelines and goals.

One branch comprises financial, profit oriented enterprises falling under market regulations whereas the other group includes such not-for-profit financing bodies as funds.

The latter, if the regulations of their country of operation permit it (as is the case in Hungary), are not bound by market regulations.

The operations of these two branches of the microfinancing sector differ significantly.

Often, the profit oriented branch is aimed at increasing profits and not at resolving the above problem. This branch is primarily governed by market rules, so its support is up to national level decision-makers and mainly consists of regulatory activities.

From our perspective, not-for-profit microfinancing takes precedence as it involves actors that favour social goals over profit oriented approaches.

Whenever public money is allocated towards resolving a social issue, the social issue in question must be given priority.

The good practices revealed and demonstrated during our project also relate to the area of non-profit microfinancing.

Therefore, it is important to bear in mind that the development of microfinancing is only a means to resolve a given social problem and not the goal itself.

This explains why the standards on behaviour and accounting provided by the European Union for microfinancing bodies have failed to meet expectations even though the envisaged goals were clearly positive.

The codex is written primarily for investors and contains guidelines on the operation of profit oriented microfinancing bodies. Most not-for-profit microfinancing bodies are unable to meet these standards. Even if they manage to do so, this would include modifications, which, if implemented, will hinder these bodies in operating in line with the social goals they originally set for themselves.

Unfortunately, central EU funding is limited to microfinancing organizations in compliance with these standards.

In this regard, the European Union behaves as a profit oriented investor, and uses the public money towards microfinancing to fund profit oriented microfinancing organizations.

Instead of looking for a solution to the social problem, the EU focuses on the financing of those microfinancing bodies that meet the regulations. Unfortunately, certain nations also follow this mistaken approach in their financing policy.

This practice does little to solve the problem as many actors are at a disadvantage compared to profit oriented microfinancing enterprises in obtaining funding. This follows primarily from the former's inability to provide the required legal safeguards, and from the fact that the applicable financial regulations limit the level of risk these businesses are legally permitted to take.

Overall, the main lesson to be drawn from this Project is that the solution of the social problem in question should receive the most attention for the purposes of which new programs must be implemented in the microfinancing sector.

Tibor Szekfü

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ANNEXES – Case studies

HUNGARY

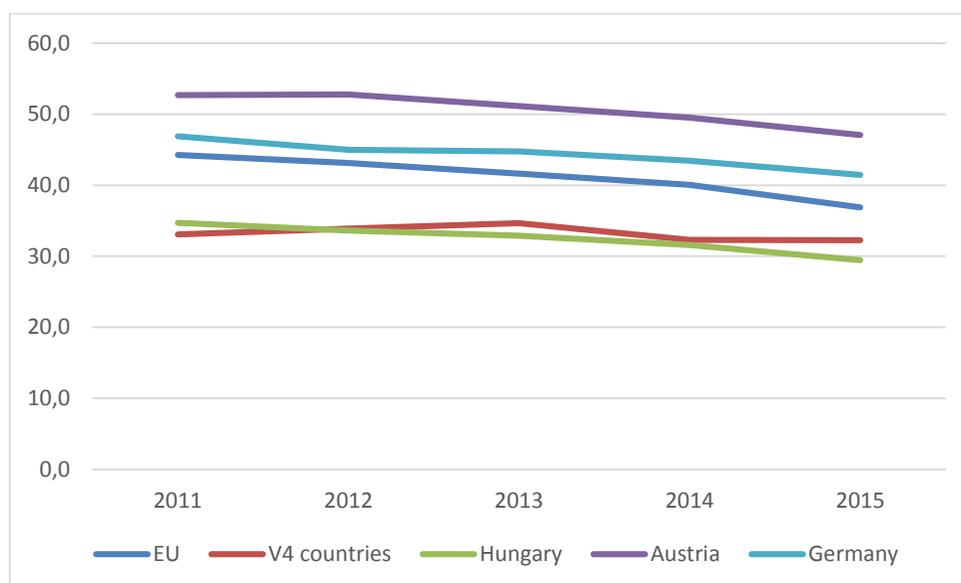
Financial exclusion and access to microfinance

Overview on regional financial services

1.1. Short overview on the available banking services in Hungary

This chapter describes the characteristics of the available Hungarian banking services with special regard to the following issues: geographic coverage of the services, availability of remote banking services, requirements to access a credit product for entrepreneurs (e.g. risk assessment procedures).

Figure 18: Number of bank branches per 100,000 inhabitants



Source: ECB, Eurostat

Density of bank branches in Hungary lags behind the EU average (see Figure **Hiba! A hivatkozási forrás nem található.**) by a constant difference in the past years. Compared to the Visegrad countries⁴², Hungary shows almost the exact average figures of the V4. Just like at most places in Europe the growth rate of bank branches was the highest in Hungary before the financial crisis (12.9% year-on-year change in Q1 2006).⁴³ During the years of the financial crisis and in recent years a visible and steady decline is observed (34.7 per 100,000 inhabitants

⁴² Czech Republic, Hungary, Poland, Slovakia

⁴³ Central Bank of Hungary

in 2011, 29.5 in 2015).⁴⁴ This trend is very much parallel with that of the EU average or Germany and Austria. According to the Financial Stability Review of the European Central Bank (May 2016) banks as part of their cost-cutting activities have started to rationalize their retail branch network, also as a response to increased customer demand for the use of banking services via digital platforms.

According to the Global Finance Development Report 2014, the following characteristics describe the Hungarian financial system:

- account at a formal financial institution (% , age 15+): 72,7%
- loan from a financial institution in the past year (% , age 15+): 9,4%
- electronic payments used to make payments (% , age 15+): 28,7%
- debit card (% , age 15+): 62,4%
- firms with a bank account: 97,7%
- firms with a bank loan/line of credit: 43%
- firms using banks to finance investments: 48,7%
- bank branches per 100.000 adults: 15,7%

Looking at regional differences, Central Hungary and West-Transdanubia is best supplied with bank branches, whereas some micro-regions in the Northern-Great Plain and North Hungary show the lowest density figures. Concerning the size of settlements, the higher the number of inhabitants in a settlement the higher the density of bank branches is. Principally, banks avoid towns with inhabitants fewer than 2,000 inhabitants and villages. In 2008 only 9 bank branches operated in such settlements (which give 75% of the total settlements in Hungary with 1.7 million people – 17% of the total population – living there).⁴⁵

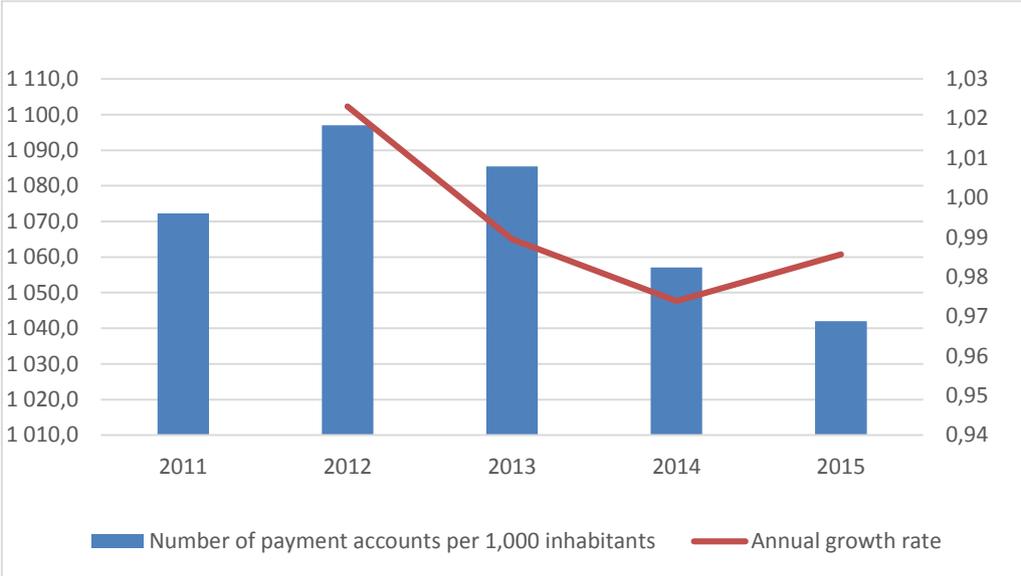
Savings cooperatives operated in 43% of the settlements in Hungary in 2008 and in 1087 settlements they were the only financial service providers. 80% of those settlements where savings cooperatives operate have fewer than 5,000 inhabitants and 48% of them have fewer than 2,000 inhabitants. More than 2 million people live in such settlements where the only service providers are savings coops.

The number of bank accounts per 1,000 inhabitants show a slight decline from 2012 standing at 1042.0 in 2015 (see Figure 19). Potential reasons behind may be the cost rationalization of account holders (in 2013 a fee on transaction was introduced in Hungary) and low yields on savings.

⁴⁴ Other sources quote somewhat different numbers for the numbers of bank branches: 1) According to www.portfolio.hu (and using population numbers of www.ksh.hu) in 2015 there were 28.4 bank branches per 100,000 inhabitants. According to the Global Financial Development Report 2014 there were 15.7 bank branches per 100,000 adults in Hungary.

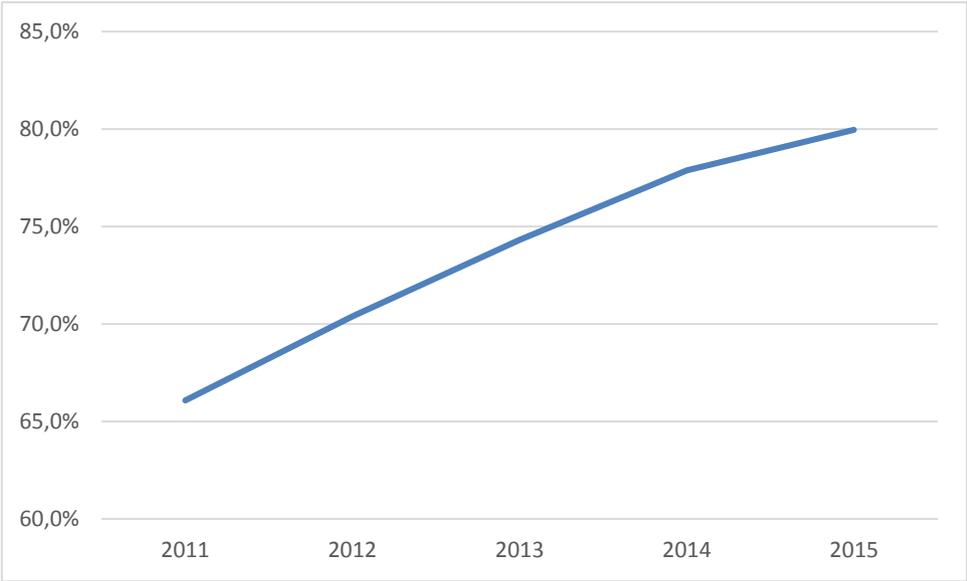
⁴⁵ Zoltan Gal - Hungary in Maps. Bank network. HAS Geographic Research Institute, 2009

Figure 19: Number of bank accounts per 1,000 inhabitants in Hungary



Source: Central Bank of Hungary, Hungarian Central Statistical Office

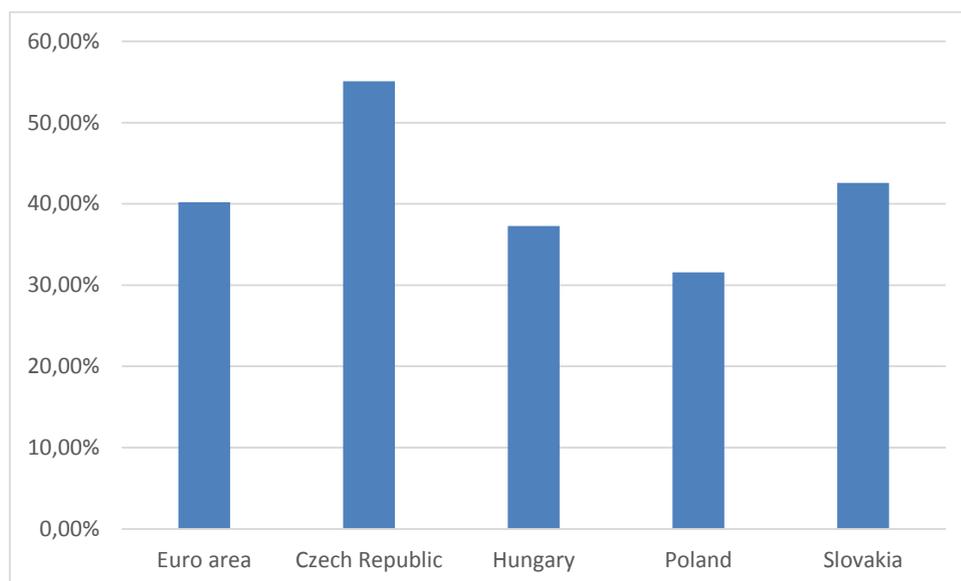
Figure 20: Ratio of bank accounts accessible via Internet or dedicated software in Hungary



Source: Central Bank of Hungary

The ratio of bank accounts accessible via Internet or dedicated software shows a quasi linear increase in the past years standing at 80.0% in Hungary in 2015 (see Figure 20). This is seen as a very beneficial progress since electronic and digital platform solutions make a growing number of banking services accessible from remote distances.

Figure 21: Ratio of firms having a bank loan/line of credit, 2013



Source: Global Financial Development Dataset

According to the Global Financial Development Dataset 37% of firms had a **bank loan/line of credit** in 2013 in Hungary (see Figure 21). This is just slightly under the average value of the Euro area (40%) and surpasses the Polish figure (32%). The other two Visegrad countries, Czech Republic and Slovakia have higher ratios (55% and 43%, respectively).

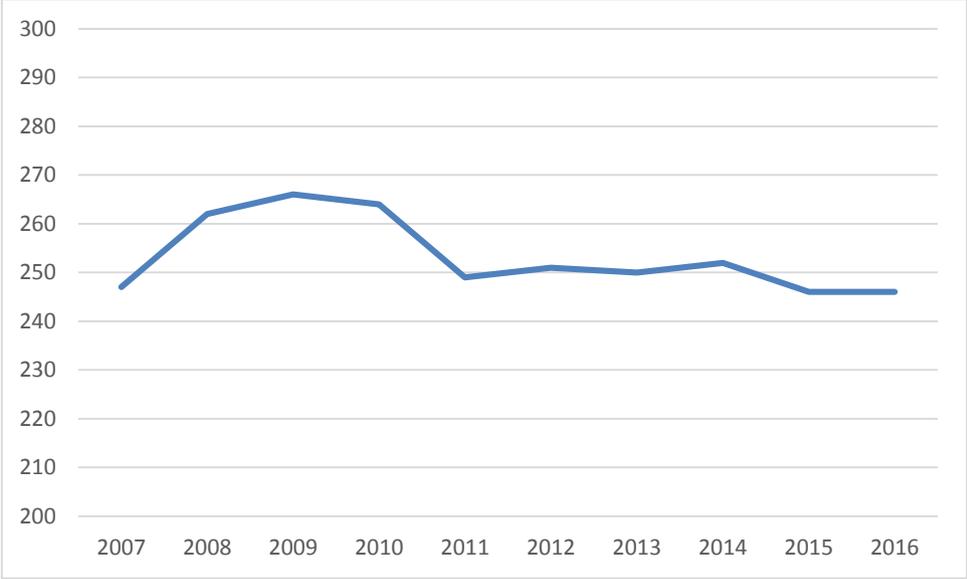
In the banking sector **requirements to access credit products** have been rather conservative in recent years in Hungary. Banks prefer existing clients, with which they had loan agreements before. A substantial change was brought by the Growth Loan Programme of the Central Bank of Hungary in 2013 (see details later). Micro-enterprises and companies without track-record were given a slight chance to receive a credit/loan product at banks. Applicant enterprises normally enter a formal risk assessment procedure, in which the financial-track record, current financial situations and business plans are examined. A collateral is always required to get access to credit products, which is increasingly considered as the main barrier for SMEs in obtaining access to finance.

1.2. Financial services provided by the non-banking sector in Hungary

Number of non-bank financial enterprises has been fairly stable in the past years in Hungary with around 250 services providers (see Figure 22). According to the relevant act⁴⁶, financial enterprises can only provide a limited financial service portfolio compared to credit institutions and cannot collect savings, among others. Financial enterprises typically focus on one core area like factoring, overdue accounts receivables management, car financing, consumer loans, etc.

⁴⁶ Act No. 237 of 2013 on credit institutions and financial enterprises

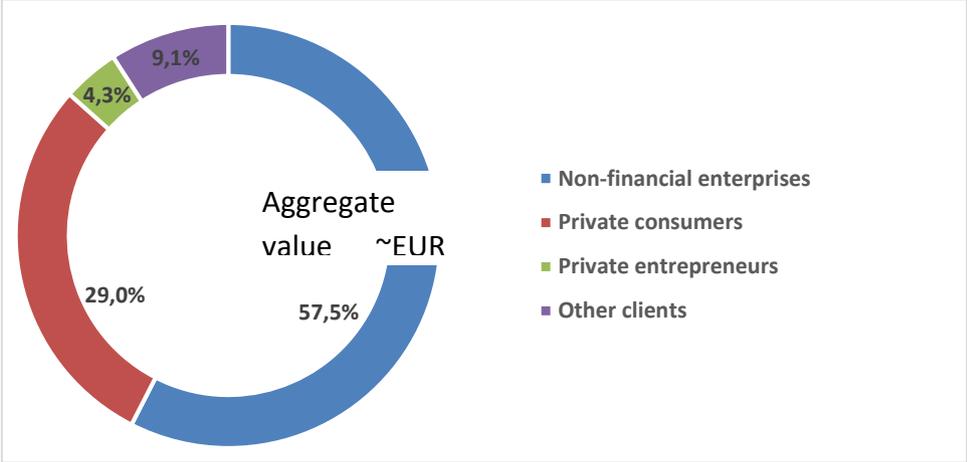
Figure 22: Number of non-bank financial enterprises in Hungary



Source: Central Bank of Hungary (2016 figure relates to 30.06.2016)

The aggregate value of accounts receivables of financial enterprises is around EUR 5,095 billion according to the data of the Central Bank of Hungary. Companies and private entrepreneurs make up for 62% of the total accounts receivable value of the financial enterprises, whereas private consumers take a 29% share (see Figure 23).

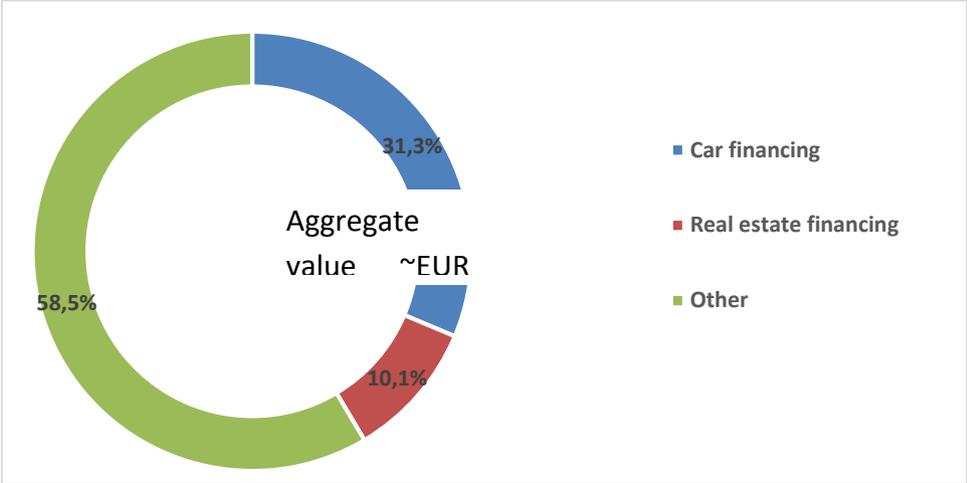
Figure 23: Aggregate accounts receivables portfolio of financial enterprises by client categories as of 30.06.2016



Source: Central Bank of Hungary

Concerning the subject of the business deals (see Figure 24) the two most relevant single items are car financing (31.3%) and real estate financing (10.1%).

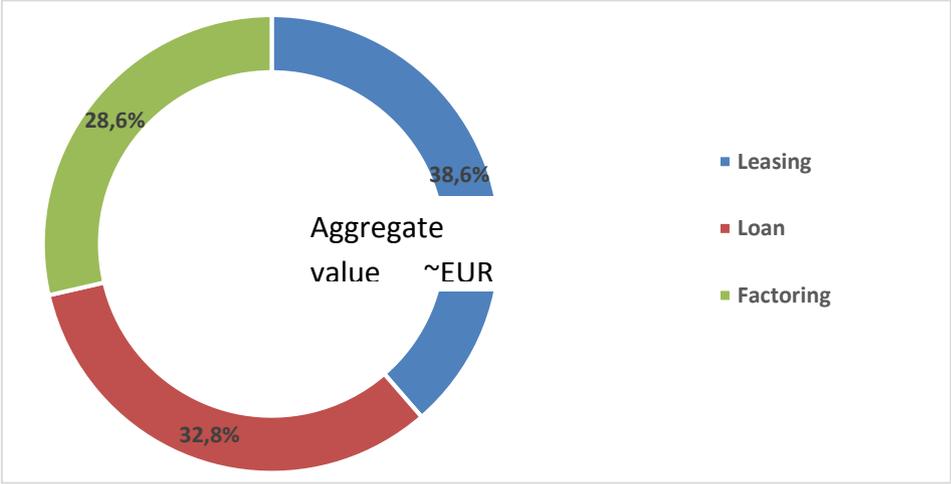
Figure 24: Aggregate accounts receivable portfolio of financial enterprises by business types as of 30.06.2016



Source: Central Bank of Hungary

Looking at the financial mean of the portfolio of the financial enterprises leasing contracts make up for 38.6% of the portfolio, 32.8% are loan contracts and the remaining 28.6% are factoring deals (see Figure 25).

Figure 25: Aggregate accounts receivables portfolio of financial enterprises by financing mean as of 30.06.2016



Source: Central Bank of Hungary

The overwhelming majority of the non-bank financial enterprises are registered in Budapest and most of the remaining ones are registered in large towns. Most of the financial enterprises have a website but their functionality is rather low and is limited to information provision. Only few offer on-line services especially with regards to credit assessment.

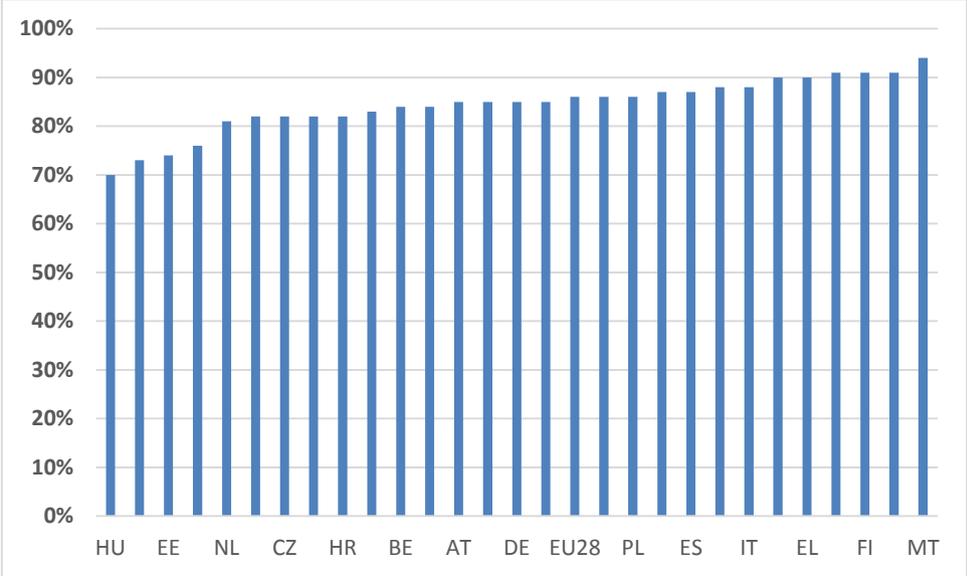
A specific, experienced and active segment of the Hungarian non-banking sphere is **the local enterprise agencies** operating as foundations. The 20 agencies are allowed to provide microcredit financing without the involvement of banks. The target group of these agencies is those private entrepreneurs, micro and small enterprises that fall out of scope of commercial

banks. Clients requesting microcredit enter a formal credit assessment procedure assisted by a customized electronic credit scoring system.

1.3. “Unbankable” enterprises: main barriers for SMEs in accessing banking services

According to the Access to Finance 2015 survey debt financing has the least relevance for SMEs in Hungary (70%) among the EU28 (average figure 86%, see Figure 26) that has a number of reasons including the financial crisis, the transparency of SMEs, the traditional preference to internal financing, etc. The financial crisis set back substantially both the supply and demand of credits and loans for SMEs. Similarly, to private consumers a visible share of SMEs had engaged into foreign currency loans before the financial crisis (although not to the extent as private consumers had done). When the financial crisis brought the heavy depreciation of the Hungarian forint, the indebtedness of concerned SMEs rose suddenly and sharply, resulting in increased insolvency ratios. On the other hand, banks changed their lending attitude and restricted the provision of new loans to existing clients with excellent track records and high collaterals. The demand and supply impacts have resulted in an almost complete freezing of the SMEs’ loan market by 2010-2012. In such an environment the Central Bank of Hungary initiated a massive lending programme called the Growth Loan Programme in 2013 pouring a virtually unlimited amount of liquidity in three steps into SMEs through banks at highly preferential interest rates and favorable risk sharing.

Figure 26: Relevance of debt financing for SMEs in the EU28, 2015



Source: SAFE Analytical Report 2015

Table 5: Used sources of financing in the past six months (April to September 2015)

	Hungary	EU28
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Credit line, bank overdraft, credit cards overdraft	22%	37%
Bank loans	7%	19%
Leasing, hire-purchase	14%	23%
Trade credit	4%	20%
Grants or subsidized bank loans	9%	8%
Retained earnings or sale of assets	8%	15%
Other loans	8%	10%
Equity capital	<1%	2%
Factoring	1%	6%

Source: SAFE Analytical Report 2015

When comparing used sources of financing in Hungary with the EU28 average (see Table 5), it can be seen that Hungarian SMEs use all types of financing to a more limited extent with the exception of grants and subsidized bank loans, which comes as no surprise. Debt financing offered by banks shrank substantially as written above, moreover at the time of the survey EU grants were heavily used by SMEs and the loan market was dominated by the so-called Growth Loan Programme initiated by the Central Bank of Hungary. Beyond that the financial instruments offered in the frame of the Economic Development Programme 2007-2013 were available for SMEs, as well.

A recent gap analysis written to the financial instruments of the EDIOP 2014-2020⁴⁷ quotes that 60% of SMEs perceive that access to finance is hampered by certain obstacles. Considering the Hungarian loan market currently - including the Growth Loan Programme - and looking at SMEs with track-record and acceptable financials, the number one obstacle in access to finance is **high collateral requirements**.

Financial awareness of the population

1.4. Over-indebtedness of the population and prevention measures

Indebtedness of the Hungarian population was significantly lower than the average of the euro area countries in 2000-2004. However, in the credit boom before the financial crisis the growth rate of the indebtedness ratio was significantly higher in Hungary than in the euro countries owing to the extremely fast spread of foreign currency loans. When the crisis hit in the high volatility of exchange rates and especially the substantial depreciation of the

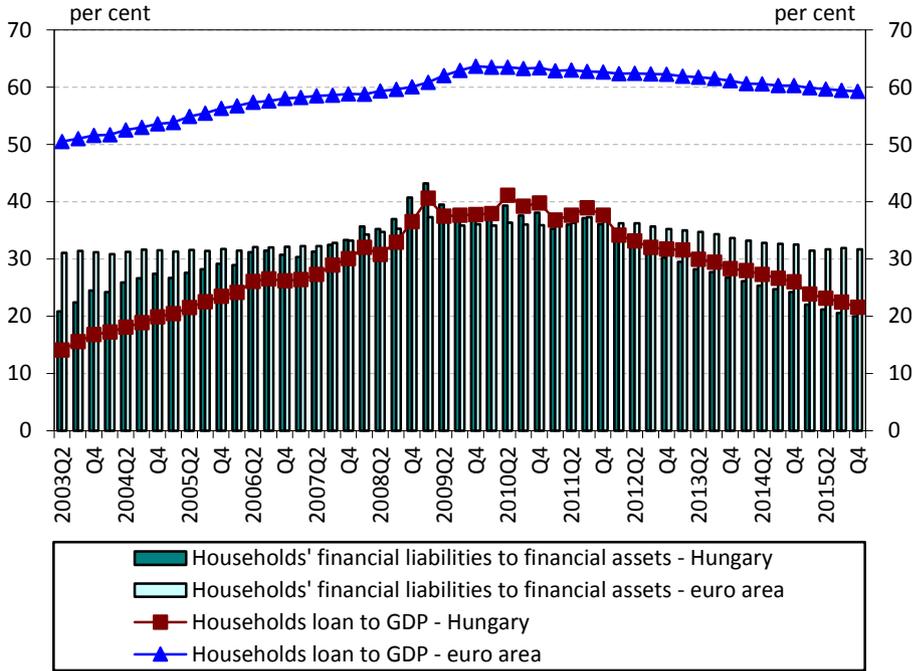
⁴⁷ Deloitte: Ex-ante expert study related to thematic objective No. 3 for the Economic Development and Innovation Operational Programme, 2014.

Hungarian forint raised the indebtedness ratio even further. As a result of these the indebtedness ratio of the Hungarian population exceeded the euro area average in 2008-2010. For a large share of the concerned population this brought along unbearable burdens. As a consequence, the government has initiated a series of administrative steps to terminate foreign currency loans. This, together with a remarkably changed attitude of the population eventuated that by the end of 2015 the indebtedness ratio was 19.97% as compared to the euro area average of 31.69% (see Figure 27).

Measures of the government included:

- restricting the possibility of unilateral interest rate increase of loans by banks
- introducing the exchange rate cap system, i.e. debtors could pay back installments of their foreign currency loans at artificially set exchange rates (which were more favorable than the market exchange rates)
- full prepayment of foreign currency loans at artificially set exchange rates (which were more favorable than the market exchange rates)
- purchase of real estate collaterals of defaulted loans from banks (which made possible that defaulted debtors were not evicted from their flats that they offered as collateral to their loan)
- full conversion of foreign currency loans to Hungarian forint loans

Figure 27.: Indebtedness of households in international comparison



Source: Central Bank of Hungary

1.5. Level of financial literacy and education

Hungary participated in the 2012 OECD/INFE⁴⁸ pilot study that measured financial literacy in 14 countries on 4 continents.⁴⁹ We sum up the results for Hungary and compare those to the other 13 participating countries.⁵⁰ 3 dimensions of financial literacy was examined as follows:

1. Financial knowledge

8 questions on financial knowledge were posed to survey participants (see the columns in Table 6). The top row of the table shows the ratio of correct replies for Hungary for the 8 dimensions. The row 'Average' shows the average values for the 14 participating countries and the 'Rank of HU' row shows the ranking of Hungary compared to the results of the other countries. The results show that the Hungarian population has an above average financial knowledge (Hungarian correct replies surpassed average results for all 8 questions). Moreover, in the case 6 questions from 8 correctness of replies puts Hungary to a top 3 position in the group of participating countries.

Table 6: Results of dimension "Financial knowledge" in the 2012 OECD/INFE pilot study

	Division	Time value of money	Interest paid on loan	Calculation of interest plus principle	Compound interest and correct answer to previous question	Risk and return	Definition of inflation	Diversification
Hungary	96%	78%	95%	61%	46%	86%	91%	61%
Average	86%	70%	82%	58%	30%	71%	80%	53%
Rank of HU	1	5	1	6	3	1	2	2

Source: 2012 OECD/INFE pilot study

⁴⁸ International Network on Financial Education

⁴⁹ Atkinson, A. and F. Messy (2012), „Measuring Financial Literacy: Results of the OECD/International Network on Financial Education INFE Pilot Study”, OECD Working Papers on Finance, Insurance and Private Pensions No. 15, OECD Publishing. <http://dx.doi.org/10.1787/5k9csfs90fr4-en>

⁵⁰ Participating countries: Albania, Armenia, Czech Republic, Estonia, Germany, Hungary, Ireland, Malaysia, Norway, Peru, Poland, South Africa, UK, BVI

2. Financial behavior

Financial behavior of the Hungarians brought mixed results. In this category 9 questions were raised to participants. Out of these Hungarians performed above average only for 1 question that was about careful consideration of purchases. For all other questions Hungary produced average or below average results (see Table 7) and was the weakest among participants when asked about active saving or buying investments in the past year.

Table 7: Results of dimension “Financial behavior” in the 2012 OECD/INFE pilot study

	Behavior statements				Financial product choice				
	Carefully considers purchases	Pays bills on time	Keeps close watch on personal financial affairs	Sets long term goals and strives to achieve them	Responsible and has a household budget	Has been actively saving or buying investments in the past year	...after gathering some info	... after shopping around and using independent info or advice	Has not borrowed to make ends meet
Hungary	86%	82%	71%	52%	31%	27%	48%	4%	86%
Average	82%	82%	79%	53%	44%	60%	44%	6%	81%
Rank of HU	6	9	12	9	11	14	7	8	8

Source: 2012 OECD/INFE pilot study

Looking at together the responses for financial knowledge and financial behavior it gives the interesting result that Hungarians have an above average financial knowledge which is however not reflected in their financial behavior.

3. Financial attitudes

Table 8: Results of dimension “Financial attitude” in the 2012 OECD/INFE pilot study

	Disagrees with the following attitude statements:		
	I find it more satisfying to spend than save it for the long term	I tend to live for today and let tomorrow take care of itself	Money is there to be spent
Hungary	56%	68%	33%
Average	45%	60%	29%
Rank of HU	5	3	4

Source: 2012 OECD/INFE pilot study

The third examined aspect of financial literacy was financial attitudes, which focuses on the long term financial planning habits of respondents. Hungarian respondents produced above average replies for all 3 questions raised in this aspect, which shows that Hungarians tend to care about financial planning for the future (see Table 8).

Measures to increase access on regional or national level

3.1 Regional policies, strategies to prevent financial exclusion

The most relevant policies are the concerned priority axes and measures of the previous and current economic development operational programmes:

- Priority Axis 4 of the Economic Development Operational Programme 2007-2013
- Financial Instruments measures in Priority Axis 1 of the Central Hungary Operational Programme 2007-2013
- Priority Axis 8 of the Economic Development and Innovation Operational Programme 2014-2020
- Financial Instruments measures in Priority Axis 1 of the Competitive Central Hungary Operational Programme 2014-2020

Economic Development Operational Programme 2007-2013 (EDOP)

Geographically EDOP covered development projects that were implemented in the 6 convergence regions of Hungary (the whole territory of Hungary excluding Budapest and Pest County). One of the four specific objectives of EDOP was the facilitation of access to financing resources for SMEs. As EDOP stated: "To overcome market failures that hamper the development of smaller, capital-short enterprises lacking appropriate market background, depending on the actual circumstances different kinds of financial instruments can be applied. "One of these instruments was to provide credits including micro-credit and small credit,

among others. Beyond that, EDOP claimed that the “the biggest obstacle for higher volume bank financing of SMEs is the lack of credit guarantee, as well as the management of special risks of small enterprises that can be overcome by using guarantee instruments.”

Priority Axis No. 4 of the Economic Development Operational Programme was fully dedicated to financial instruments with an allocated amount of EUR 727 million. In total 10 products (4 loan products, 3 guarantee products, 3 venture capital products) were managed in EDOP and altogether 15,560 projects used some kind of financial instruments assistance.

Central Hungary Operational Programme 2007-2013 (CHOP)

Geographically CHOP covered development projects that were implemented in Central Hungary (Budapest and Pest County). The first priority axis of CHOP tackled economic development. Concerning its specific objectives and measures it mirrored those of EDOP. The total financial frame of financial instruments was cc EUR 127.4 million. 9 products were managed in CHOP and altogether 3 623 projects used some kind of financial instruments assistance.

Economic Development and Innovation Operational Programme 2014-2020 (EDIOP)

Similarly to the previous programming period EDIOP provides financial assistance to development projects in the 6 convergence regions of Hungary. Priority Axis No 8 (Financial Instruments) “provides funding for the enterprise sector, mainly SMEs and social enterprises receiving no/not enough funding from market sources throughout the territory of the country.” Measures in the priority axis contribute to the fulfilment of the specific objectives defined under the other EDIOP priorities (Priority 1-7), complementing the results of non-refundable grants. The concerned thematic objectives are: enhancing the competitiveness of SMEs (TO3c), strengthening research, technology development and innovation (TO1b), supporting the shift towards the low-carbon economy (TO4b, c) and, moreover, enhancing access to, use and quality of ICT (TO2a, b) and promoting sustainable and quality employment and supporting labour mobility (TO8b). Where grants are solely insufficient to support the realization of a project, their combination with financial instruments is envisaged mainly in case of the grants of EDIOP Priorities 1-7, and EEEOP⁵¹ Priority 5. The allocated amount of EDIOP Priority Axis No 8 is fairly large, amounting to EUR 2,235 million.

Competitive Central Hungary Operational Programme 2014-2020 (CCHOP)

Geographically CCHOP covers development projects that are implemented in Central Hungary (Budapest and Pest County). The first priority axis of CCHOP focuses on the improvement of competitiveness of enterprises. Concerning its specific objectives and measures it largely mirrors those of EDOP. The total allocated amount of financial instruments is cc EUR 100 million.

⁵¹ Environmental and Energy-Efficiency Operational Programme

3.2. Regional initiatives to improve access to microfinance

Combined microcredit programme under EDOP 2007-2013

The combined microcredit programme was launched under the Economic Development Operational Programme 2007-2013 in January 2011. The programme used an innovative tool: combining microloans (funded from EDOP Priority Axis No. 4.) and non-refundable grants for micro-enterprises (funded from EDOP Priority Axis No. 2). The micro-entrepreneurs submitted their application to a financial intermediary who then had three weeks to assess the loan application. If a positive loan decision was reached, the financial intermediary made the micro-entrepreneur a loan proposal. At the same time, the grant agency (intermediary body) had to assess the non-refundable grant application within 30 days. The financial intermediary and the grant agency informed the Managing Authority of their decision. The final decision was made by the Managing Authority. At least 10% of the total eligible costs of the project had to be provided by the micro-entrepreneur as own resources. The loan volume could range from EUR 3,200 to EUR 65,000 and the grant from EUR 3,200 to EUR 32,350 (calculating with 310 HUF/EUR). The programme attracted very high interest from private entrepreneurs and SMEs. Altogether 7820 projects were funded from all over the 6 convergence regions of Hungary with the aggregate contract value of EUR 173.4 million.

New Szechenyi Loan Programme under EDOP 2007-2013

The New Szechenyi Loan Programme was kicked off in 2011 by merging two previous financial instruments into one. The objective of the programme was to provide access to finance for micro- and small companies that are not served by banks. The preceding instruments were a micro-credit scheme and a small credit scheme. The Programme was funded from EDOP Priority Axis 4 (Financial instruments). Financial intermediaries included microfinancing institutions, financial enterprises, savings cooperatives and banks that were selected through an open call. Altogether 108 financial intermediaries have been selected in the Programme. Refinancing was provided by the programme (through the holding fund manager on behalf of the EDOP managing authority) to the financial intermediaries. The refinancing rate was different based on the type of the financial intermediary (banks had the lowest refinancing rate). The objective of the micro/small loan was capacity development of micro and small- and medium sized SMEs. The maximum amount of loan differed by the type of the financial intermediary: EUR 32,000 if the loan was contracted through an enterprise development foundation, EUR 161,290 through financial enterprises and EUR 1,612,290 through banks (EUR 1 = HUF 310). The programme fully reached its objective: together with its antecedent schemes from 2007 5,281 loan deals were contracted in a total volume of EUR 258.4 million (EUR 1 = HUF 310).

ITALY – Sardinia

Financial exclusion and access to microfinance

1. Overview on regional financial services

1.1. Short overview on the available banking services in the region

In 2015, the banking and financial system in Sardinia included 28 banks, both national and local, with at least one active branch.

Between 2008 and 2015, we have assisted to an evident downsizing of the territorial banking network, which shrank by 7.9%, recording 643 operating branches in 2015. The decrease is mainly attributable to major banks, which have reduced the number of branches in Sardinia more than elsewhere in Italy, and to a lesser extent to foreign banks.

Furthermore, the contraction has mainly concerned those areas where there was a greater number of branches while in most of municipalities the banking presence has not substantially changed.

In connection with a higher degree of automation of banking services, the reduction of operating branches and locations served by banking intermediaries has been offset by an increase in both the ATMs (from 721 to 757 units) and the number of POS (from about 45,000 to 48,600).

The region continues to be characterized by a modest level of bank services: the density of the branches (2.7 units per 1002 km) is considerably lower than in the South (5.2 units per 1002 km) and especially in comparison with the Italian average (9.9 units per 1002 km). Taking into consideration the number of residents, Sardinia records a lower indicator if compared to the national average (39.2 branches for every 100,000 inhabitants, while in Italy it is around 50.6).

Banking system in Sardinia				
	2004	2009	2014	2015
Banks with own branches	29	30	27	28
Operating branches	677	669	654	643
Municipalities with bank services	329	311	304	296
N° of financing relationships per branch	940	833	779	911
N° of bank accounts per branch	1.453	1.533	1.976	2.079
POS	24.857	36.138	44.718	48.594
ATM	586	833	721	757

Source: The economy of Sardinia (The Bank of Italy, 2016)

Figure 28: Bank branches in Sardinia (2008-2015)

	2008	2014	2015	Var. % 2014/15
N° branches	698	654	643	-1,7
<i>Branch distribution according to bank typology (in percentages)</i>				
Large banks	88,4	87,1	86,9	-1,9
Medium-sized banks	2,1	2,6	2,7	1,0
Small banks	3,9	3,7	3,8	1,0
Foreign banks branches	5,6	6,6	6,6	-1,4

Source: The economy of Sardinia (The Bank of Italy, 2016)

As for bank loans, since 2015 a favourable trend has been evolving in terms of easier conditions of credit access, although they are still more limited to companies in industry and services.

Such improvement is mainly due to an increased competitive pressure among intermediaries and reduced financing costs in connection with the expansive monetary policy put in place by the European Central Bank. More favorable credit policies have had a positive impact in the reduction of interest rates for both average loans and those applied to more “risky” customers.

Last available data confirm the growth of loans to businesses, in particular in the manufacturing industry, but mainly with reference to medium-sized and large enterprises and to customers classified as “non-risky”.

Figure 29: Bank loans in Sardinia 2013-2015 (in million euro)

	2013	2014	2015
Public Administration	1.188	1.068	1.053
Private sector	23.409	24.640	25.749
<i>1. Financial and insurance companies</i>	1.467	2.707	2.651
<i>2. Enterprises</i>	11.926	12.094	12.444
<i>Medium-sized and large enterprises</i>	8.487	8.681	9.039
<i>Small enterprises</i>	3.440	3.412	3.405
<i>3. Households</i>	9.878	9.709	10.528
Total	24.597	25.708	26.802

Source: The economy of Sardinia (The Bank of Italy, 2016)

1.2. Financial services provided by the non-banking sector in the region

In Sardinia we find different types of financial services provided by the non-banking system, both in the private and public sector, and, for limited scopes, in the religious sphere as well. The development of new channels, as alternative to traditional banking credit, has been determined by the growing awareness of the existence of a wide category of persons who cannot access to credit due to the lack of sufficient financial guarantees. Like in other southern Italian regions, the public sector is actively engaged with various instruments managed by the central government, regions, other local authorities and even some universities. The Sardinia Region, in particular, has a consolidated tradition in the provision of incentives, grants, guarantees and venture capital, but also in the development of specific economic projects. Generally, it operates in the field through its in-house financial institution, SFIRS SpA (Società Finanziaria Regione Sardegna), which has over 45 years of experience in supporting local enterprises (among others, SFIRS manages the allocation of microcredit funds). On the private side, an active role is played by trade associations and guarantees consortia, especially those linked to the cooperatives system. In this case, financial products and services mainly refer to the granting of guarantees, but new initiatives have been developing in relation to microcredit and crowdfunding. Concurrently, other non-profit associations and religious institutions (e.g. the Italian Episcopal Conference and Caritas) provide financial assistance in terms of small credit allocation or support services delivery.

1.3. “Unbankable” enterprises: main barriers for SMEs in accessing banking services

In the last decade, especially after the start of the global crisis, there has been a growing attention towards the so-called “unbankable” enterprises, namely those companies and individuals (who want to start a new entrepreneurial initiative) with difficulties in accessing credit through traditional channels.

According to regional guidelines for microfinance provision, “individuals with difficulties in accessing credit and in disadvantaged conditions” are defined as “non-bankable” as they are not considered adequate to get services and/or financial products through the traditional financial sector because they do not meet the “bankability” requirement.

In other words, “unbankable” enterprises or individuals do not offer enough refund capacity, as resulting from examination of their credit history and other variables such as employment status, repayment ability and the economic validity of the initiative to be financed. As for “disadvantaged workers”, EU rules (see EU Regulation n. 651/2014, 17 June 2014, art. 2), include, in this category, people without a regular paid employment for at least six months; those in general, with reference to refund capacity evaluation, the following factors are examined: the amount of income received; the possession of formal guarantees; specific banking and credit exposure; any other available information regarding the ability to repay the loan; without an upper secondary educational or vocational qualification; workers over 50 years of age; adults who live alone with one or more dependents. With reference to the “unbankable” subjects as described above, last available data show a marked difficulty in

obtaining credit due to several factors in relation to personal characteristics and objective circumstances. In this context, it is important to underline that the uncertain economic outlook, high risk of insolvency of certain applicants and the complexity of assessing the solidity of each debtor have generated adverse selection procedures and led to the adoption of restrictive credit funding policies. According to 7th Observatory of Credit to Small Business (<20 employees), carried out by Fondazione Impresa in 2015, the main difficulties in obtaining credit for Italian small companies is mainly linked to the demand for excessive collaterals (49.5%) but also to high interest rates (23.4%) and excessive procedural times (21.2%). The data contained in the Observatory demonstrate that, despite the first signs of general economic recovery, banking loans to enterprises, notably those with a limited dimension, are still low, especially if considering the trade and craft sector.

2. Financial awareness of the population

2.1. Over-indebtedness of the population and prevention measures

The latest data contained in the EU-SILC survey, as reported by the Bank of Italy study “The Economy of Sardinia (2016), in 2014 the 30.9 % of households in Sardinia was indebted, mainly for a mortgage or consumer credit while the 6.5 % had both types of debt. The percentage of indebted households in Sardinia remains among the highest in Italy, especially in connection with the increased use of consumer credit. In this context, a critical element is represented by the exposure to potential risks of illiquidity, namely the capacity to pay off the debt. In Sardinia in 2014 households potentially illiquid was 3.8%, a lower rate if compared to the previous year, but still higher than the national average.

Indeed, the economic crisis that hit Italy in recent years has brought an increasing number of households and small businesses to find themselves submerged in debt they can't cope with. This situation involves thousands of consumers and companies in Sardinia, too.

According to other surveys, such those conducted by CRIF (the leading provider of banking credit information), the latest partial data for the first semester of 2016 show a higher percentage rate of indebted population in Sardinia, equal to 36%, which rises up to 39.1% if considering only private loans. However, the average monthly payment in Sardinia is one of the lowest if compared to other Italian regions.

The indebted households are exposed to potential risks of illiquidity when their income is less than the costs to be incurred for debt services and to ensure basic living standards (event for their own components) and they do not have, at the same time, sufficient financial assets to cover such deficit.

In order to face this phenomenon, the Italian legislator adopted law n°3/2012 with the objective of supporting companies and households to reduce the burden of debt accumulated over the years.

The regulation was introduced in consideration of the need to give, in case of insolvency of debtors who cannot be subject to bankruptcy, the opportunity to restructure the debt and to regain an active role in the economy, without being crushed by the pre-existing debt load.

Several consumer associations are actively committed in supporting companies and households in order to take advantage of the opportunities offered by the above-mentioned law and assess the most appropriate procedure to save their assets.

Nonetheless, a special attention is also given to the provision of adequate and quality information in relation to the prevention of over-indebtedness and the risks connected to usury.

2.2. Level of financial literacy and education

It is widely agreed that consumers often lack the skills to make financial decisions with sufficient awareness and familiarity and there is a growing importance of more literacy and education in the field in order to improve financial decision-making processes.

The financial crisis has shown the far-reaching consequences of making decisions without adequate tools. The heterogeneity of financial products and the changing attitudes towards debt and consumption may tempt people to borrow beyond their means, triggering over-indebtedness and bankruptcy and undermining financial stability.

In general, the increasing complexity of financial choices that citizens must take in the course of their life requires financial literacy levels often higher than those currently available in large sections of the population. Moreover, a greater financial culture stimulates the demand for financial/insurance products and services of better quality, with positive effects in the financial industry in terms of efficiency, competitiveness and innovation.

Given that knowledge is developed primarily at school, international institutions, authorities and scholars agree that beginning financial education at school is essential, even if pupils still have a long way to go before making their own financial decisions.

According to the OECD, "Financial education should start at school. People should be educated about financial matters as early as possible in their lives" (OECD, 2005). Nonetheless, empirical findings support the importance of financial education at school and, in particular, of starting as early as possible.

In relation to the conclusions of recent studies (such as PISA survey conducted by OECD in 2012 or the Global Financial Literacy Survey by Standard & Poor's in 2015) it appears that the financial literacy of young people in Italy is very low, both for adults and students, especially if compared to European averages.

Making financial concepts part of compulsory education can ensure equal access and favours the inclusion of disadvantaged children (who may be the most in need of financial literacy). Furthermore, it addresses financial education to a particular phase of life, when people are

most receptive, and schools represent an optimal channel from the organizational and logistical standpoint.

From this perspective, in 2007 the Bank of Italy and the Italian Ministry of Education started an experimental program to incorporate financial education into school programmes. Year after year, it has produced growing interest among teachers and learners and has proved to be effective in improving pupils' financial knowledge. Although, it is important to underline that training programmes are still subject to teachers' initiatives and there is no homogeneous education at national level.

Many institutions, financial entities and associations have been involved in financial education so far, with an important number of related educational programs promoted in the country, also on a regional level.

Financial education for adults looks less structured than that for students as it is more difficult to identify ways, places and times compatible with the availability of potential beneficiaries. At the same time, the training initiatives in this context need to be less generalist and more targeted to particularly vulnerable population groups or with special educational needs, such as women, elderly or small businesses.

The absence of a national framework defining training needs, priorities and criteria for intervention has however limited the coordination between individual actions and the activation of synergies.

The training offer appears to be too fragmented and with a modest number of participants. Nonetheless, there is no evidence of concrete results and identification of best practices as there is a deficiency of assessment reports on the ability of the initiatives to increase knowledge and affect behaviour.

According to the main stakeholders in the field, effective action in financial education requires, in line with best practice emerged at the international level, a more coordinated training offer in order to promote synergies and disseminate the most appropriate teaching methods in relation to target audience.

In approximately sixty countries coordination is pursued through a national strategy for financial literacy, but Italy is still not among them (policy developments are expected in the coming years).

3. Measures to increase access

3.1. Regional policies, strategies to prevent financial exclusion

The Sardinia regional government has a long tradition in the definition and implementation of general/sectorial strategies aiming at supporting the competitiveness of local enterprises in the framework of a more comprehensive territorial economic and social development.

In this context, several laws and instruments been adopted and applied so far in order to help business to disclose their potential, especially in those economic sectors of strategic relevance in terms of revenue-generating and job creation. Along traditional tools in support of business growth, in the last decade, the regional government has become more and more committed in the promotion of specific initiatives in favour of the financial inclusion of those individuals who face particular situation of disadvantage, in order to facilitate their entrepreneurial development.

Since the programming period 2007-13, specific initiatives have been carried out, mainly financed under the European Social Fund (ESF), European Regional Development Fund (ERDF) and the European Agricultural Fund for Rural Development (EAFRD), with the objective of promoting financial inclusion and access to credit.

In this context, it is worth to mention the following initiatives which have proved to be particularly significant in the field of preventing financial exclusion:

- ❖ Microcredit Fund (credit of limited amount to individuals or companies “non bankable”)
- ❖ SME Guarantee Fund (provision of direct guarantees, co-guarantees and counter-guarantees)
- ❖ Regional Fund for Inclusive Finance (direct guarantees and counter-guarantees)
- ❖ Venture Capital Fund “Ingenium Sardegna” (seed capital, initial capital and expansion capital to SMES and cooperatives)
- ❖ Fund for the development of the Cooperative system (risk capital investments for cooperatives)
- ❖ “PISL-POIC” fund (loans to support entrepreneurial development and job creation in favour of “vulnerable” categories, such as jobseekers, young people and women, and in specific territorial areas).

Among the priorities set up in the Regional Development Plan 2014-2019, there is the clear objective of strengthening the efforts in favour of local economic competitiveness by encouraging the creation, growth and consolidation of businesses and people skills and supporting them in addressing temporary crisis or system problems productive.

A special attention is reserved to the adoption of financial instruments for enterprises, including measures to face credit crunch and facilitate access to credit for businesses, including the development of a non-banking economy.

In this framework, the main initiatives which will be developed in the programming period 2014-2019 are the following:

- Microcredit

The action tends to consolidate the Microcredit Fund, fully implemented during the previous phase 2007-2013, in order to provide microfinance in favor of subjects with difficulties in accessing credit through traditional channels.

- Support to risk financing and access to credit

Establishment of a venture capital fund to support, directly or indirectly, the financing of the risk of highly innovative MSMEs in the pre-seed, seed and start-up. Public contributions will be provided within the limits indicated by law and will be limited to the attraction of more capital. The risk financing will also be funded through debt instruments, such as the granting of loans or guarantees.

In this context, financial existing engineering instruments will be strengthened, such as traditional guarantee schemes, along with tools that encourage the financial system liquidity through "work packages" on funding provided by financial intermediaries and guarantees provided by consortia.

- Rationalization of the regional system of credit consortia

The action is aimed at the rationalization of credit consortia, defining the conditions for their eligibility and increasing the efficiency of public resources allocated to them. In this context, the regional government intends to set up a single regional fund for the management and allocation of incentives to consortia, and the identification of measure in order to support their balanced functioning.

- Economic sectors and local development projects

The initiative reinforces the experience already gained in the field with the objective of triggering new development processes in specific territorial areas, notably those affected by crisis situations or disadvantaged development, and promoting specific productive sectors.

- Credit access in the agricultural sector

The measure intends to facilitate credit access in the agricultural sector, also in order to foster generational renewal, support entrepreneurship and boost production. In this context, the regional government plans to develop specific instruments, such as debt restructuring, microcredit, guarantees funds and incentives, in order to sustain different types of companies.

3.2. Regional initiatives to improve access to microfinance

In 2009, the regional government decided to set up a Microcredit Fund, through the regional Labour Department, as economic analysis showed that unemployment was high (especially among women and other disadvantaged categories) and credit availability was more limited than elsewhere in Italy. Moreover, several pilot projects had proven that there was an important growing demand for microcredit in the region. Operational since the programming period 2007-2013, the instrument is co-financed under the ESF Operational Programme, with the objective of fighting unemployment and social exclusion by supporting business initiatives

promoted by individuals with difficulties in obtaining credits and/or facing disadvantaged situations. The scheme is applicable to all economic sectors, but it is particularly addressed to the following key priority areas: retail, manufacturing, social and personal services, tourism, ICT, environmental protection, energy efficiency and renewable energies, cultural services, craft sector and business services. With an amount varying from a minimum of € 5,000.00 up to € 25,000.00, loans are granted at zero interest rate and through monthly payments starting six months after the conclusion of the contract (18 months for companies being funded on the date of application). In the period 2010-2015, 4 general calls plus 2 specific calls (textile, NEET) have been launched in favor of 3,600 beneficiaries (over 11,000 applications received) and with an overall granted amount of 86.5 million euro. The implementation of the instrument is confirmed in the programming period 2014-2020, where the allocation of grants will be accompanied by the provision of a wide range of support services both with reference to enterprise creation and business management (e.g. Project "Imprinting").

GERMANY

Financial exclusion and access to microfinance

1. Overview on regional financial services

1.1. Short overview on the available banking services in the region⁵²

In Germany different types of banks exist: Universalbanken (universal banks), Kreditbanken (credit banks), Landesbanken (regional banks), Sparkassen (saving banks), Kreditgenossenschaften (credit unions) and Spezialbanken (special banks). The difference in size between German banks is very significant. On the one side there are the Großbanken (big banks) and the Landesbanken (regional banks), which are normally acting in an international context. On the other side there are a lot of small and medium sized banks. There is also a difference in the legal form of German banks. Some are under private law (privatrechtlich), others are formulated by legal publication (öffentlich-rechtlich) and others are a cooperative organization (genossenschaftlich).

The following Figure shows the banks in Germany and gives an overview of their respective numbers.

⁵² All the data and information provided in the section 1.1.1 is based on the source of the “Deutsche Bundesbank” from the following website:

https://www.bundesbank.de/Redaktion/DE/Dossier/Service/schule_und_bildung_kapitel_4.html?notFirst=true&docId=147552#doc147552bodyText1

Figure 30: Banks in Germany



Source: Deutsche Bundesbank: "Das Banken und Finanzsystem"

Important to note is that the banking density in Germany has decreased a lot in the last years. In 1990 there have been around 4,700 banks in Germany. Today the number is about half of what it was in 1990. Nevertheless, Germany currently has around 2,000 credit institutions which, in comparison to other countries is still a high number.

1.2 Current accounts and online banking in Germany⁵³

Since 2005 the number of bank cards has been increased year by year. In 2005 there have been 1 million bank cards. In 2014 the number has been increased to 103.1 million.

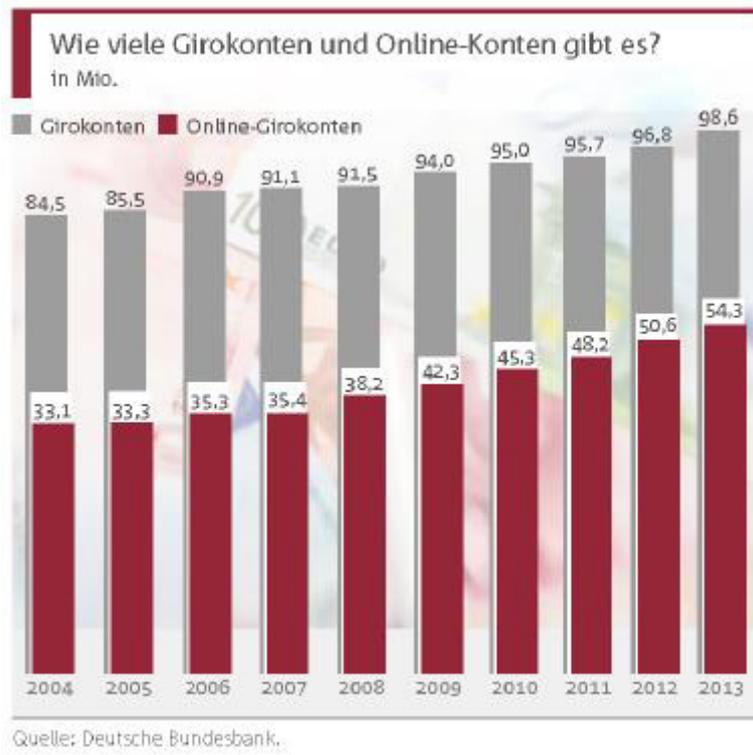
⁵³ All the data and information provided in section 1.1.2 is based on the document "Zahlen, Daten, Fakten der Kreditwirtschaft" by the Bundesverband deutscher Banken e.V. from October 2014.

Figure 31: Change of bank cards in million euros in Germany



Since 2004 the number of both the current and the online current accounts in Germany is increasing. In 2004 there have been 84.5 million current accounts and 33.1 million online current accounts, whereas in 2014 there have been 98.6 million current accounts and 54.3 million online current accounts, whereas the growth rate in the online banking sector is bigger.

Figure 32: Current accounts (Girokonto) and online current accounts (Online-Girokonten) in millions



1.3 Entrepreneurs and access to credits in Germany⁵⁴



Sparkassen (saving banks) are with 26.9% the domestic institution that provides the most credits to entrepreneurs. Together with the Kreditbanken (credit banks), which provide 24.9% of entrepreneurs with a credit, they make up more than half of the given credits to self-employed people living in Germany.

1.4. Financial services provided by the non-banking sector in the region

As stated above the regulatory framework for providing loans is regulated by the Banking Act (Kreditwesengesetz KWG). Professional provision of loans needs a banking license and therefore, loans can only be provided by banks. The national banking supervision authority BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) supervises and controls all activities of the financial market, only “significant” banks are supervised by European Central Bank. Therefore, there is no data available for this question.

⁵⁴ All the data and information provided in the section 1.1.2 is based on the document “Zahlen, Daten, Fakten der Kreditwirtschaft” by the Bundesverband deutscher Banken e.V. from October 2014.

1.5. “Unbankable” enterprises: main barriers for SMEs in accessing banking services.

The loan decision is based on business plans and has to be taken in a very short time. To this end banks employ automatized scoring systems, which are based on empirical data taking in consideration different branches, socio-cultural backgrounds, credit history, business location (red-lining), formal qualification, financial securities and formal qualifications. Also monitoring of loans and crisis intervention is not intended.

2. Financial awareness of the population

2.1. Overindebtedness of the population and prevention measures

According to the “Statistische Bundesamt” there is no data about the exact amount of overindebted persons or households in Germany available. Depending on the definition there are around 2 and 3 million people in Germany overindebted. According to the Schufa around 4.5% of German adults are overindebted. People younger than 25 years are on average indebted with 7,712 euros. People between 35 to 45 years are on average indebted with 37,901 euros. People between 65 and 70 years are in average indebted with 67,075 euros. All the data provided is based on the year 2011. The main reasons for overindebtedness in Germany in the year 2011 were the start of unemployment (27%), the separation/divorce/ death of the partner (14%), sickness, accident or addiction (12,1%) and overconsumption (11,3%). The failure of being self-employed makes up around 8.3% of the reasons why people are overindebted⁵⁵.

2.2. Level of financial literacy and education.

The OECD International Network on Financial Education (INFE) has introduced an instrument to measure financial literacy. They created a so called “financial knowledge score”. This score shows the percentage of correct answers on questions which deal with a range of financial topics. 6 or more right answers are defined as a high level of financial knowledge⁵⁶.

In comparison to the other countries according to data seems to have a very good financial knowledge. Nevertheless there is a question where not even half of the population knew the right answer and a lot of questions were answered just by around 60% of the population correctly. Financial knowledge is still a problematic topic in Germany and there is the need for financial guidance. As we have already figured out in 2.1 there are still a lot of people being overindebted. Especially young people tend to focus too much on product trends rather than on a sustainable consumption and get indebted to fulfil their product needs.

⁵⁵ <http://www.bpb.de/nachschlagen/zahlen-und-fakten/soziale-situation-indeutschland/61794/ueberschuldung-privater-haushalte>

⁵⁶ <http://www.oecdilibrary.org/docserver/download/5k9cfs90fr4.pdf?expires=1472458944&id=id&accname=guest&checksum=46CBD6FBC773DA6967AB47D40990739A>

Figure 33: Financial knowledge score

Proportion giving correct response (Cell percentages by country).

	Division	Time-value of money	Interest paid on loan	Calculation of interest plus principle	Compound interest and correct answer to previous question	Risk and return	Definition of inflation	Diversification
Albania	89%	61%		40%	10%	77%	81%	63%
Armenia	86%	83%	87%	53%	18%	67%	57%	59%
Czech Republic	93%	80%	88%	60%	32%	81%	70%	54%
Estonia	93%	86%	84%	64%	31%	72%	85%	57%
Germany	84%	61%	88%	64%	47%	79%	87%	60%
Hungary	96%	78%	95%	61%	46%	86%	91%	61%
Ireland	93%	58%	88%	76%	29%	84%	88%	47%
Malaysia	93%	62%	93%	54%	30%	82%	74%	43%
Norway*	61%	87%	61%	75%	54%	18%	68%	51%
Peru	90%	63%		40%	14%	69%	86%	51%
Poland	91%	77%	85%	60%	27%	48%	80%	55%
South Africa	79%	49%	65%	44%	21%	73%	78%	48%
UK	76%	61%	90%	61%	37%	77%	94%	55%
BVI±±	84%	74%	60%	63%	20%	83%	87%	41%

Empty cells have no relevant observations, including those where the response was not recorded. See Table 5 for question text. *The results reported for Norway under the Division column actually refer to an alternative questions posed: What is the nominal interest rate. Norway also slightly reworded the time value of money question, as they had not asked the previous question. Under interest for Norway we report responses to: What is meant by the effective interest rate. The Norwegian question reported under Risk and Return asked whether it was true or false that when you buy shares you lend money to the company. **For diversification Norway and BVI asked Buying a single company's stock usually provides a safer return than a stock mutual fund.

Data source: OECD / International Network on Financial Education (INFE) Pilot Study

A basic financial education level is essential for everybody. There are several programmes in Germany which help people to increase their financial knowledge. Important to note is that these programmes are set up for different target and age groups. Every programme is very specific and there is no uniform syllabus. There are for example programmes to help adults to achieve a basic level of financial knowledge and a few schools also provide lessons on financial education. Nevertheless, it is often not enough just to pass information on financial knowledge to people: a lot of times things like people's attitude towards money and its status symbol needs to be changed as well.

3. Measures to increase access on regional or national level

3.1. Regional policies, strategies to prevent financial exclusion

A very powerful way to prevent financial exclusion in terms of business credits are microcredits. People which are ranked as "not bankable" but who still have high potential and an enterprise with possibilities are facing a new way to get a credit and not being excluded any more.

3.2. Regional initiatives to improve access to microfinance

A local best practice programme, which was implemented in Offenbach, Duisburg, Gelsenkirchen, Leipzig and Kiel can be seen in "MIQUA" (Mikrofinanz im Quartier). This

programme helped entrepreneurs in underprivileged areas to get a microcredit in order to support their businesses.

KIZ established a special microfinance system which provided a special sponsorship for these underprivileged areas and help people to get access to external finance. In 2006 KIZ and the city of Offenbach developed the "ostpol Kredit". This is a microfinance system which is based on the cooperative model of the DMI. The aim of MIQUA was to transfer this concept also to other regions in Germany and to form an intercommunal microfinance structure. MIQUA has been introduced to Offenbach, Duisburg, Gelsenkirchen, Leipzig, Nürnberg und Kiel. Every area had his own „Quartiersberater“, a person who was the contact person for all the self-employed from this area. The "Quartiersberater" interested people informed about the credit and helped also with general business related questions. MIQUA was a very successful system to help entrepreneurs to get access to a credit. Between 2009 and 2012 MIQUA provided 150 microcredits to entrepreneurs from underprivileged areas.

SPAIN - Castile-León

Financial exclusion and access to microfinance

1. Overview on regional financial services

1.1. Short overview on the available banking services in the region

According to the Spanish SME General Directorate (DGPYME) the total number of enterprises in Spain in 2014 was 3,179,944, out of which 99.88% are SMEs. Castile-León follows the same pattern, with a total of 160,495 SMEs, representing the 99.93% of the regional enterprises.⁵⁷

Figure 34: Distribution of enterprises by size - Spain and Castile-León (2014)

	0 Employees	1-9 Employees	10-49 Employees	50-249 Employees	>=250 Employees	Total	% of Total	Total SMEs	% of SMEs
Spain	1.751.067	1.296.785	109.736	18.455	3.901	3.179.944	100,00%	3.176.043	99,88%
Castilla y León	86.948	67.971	4.936	640	112	160.607	5,05%	160.495	99,93%

Source: DGPYME (DIRCE, 2014)

Private sector initiative and investments responding to the needs of SMEs are crucial to foster growth, job creation and wealth distribution and represent the essential complement to the role of government, which guarantees the appropriate regulatory framework and service provision.

Financial services are offered throughout the country thanks to a widespread network of credit institutions and financial intermediaries. Nevertheless, the number of bank branches has dramatically decreased in the last years due to the banking sector restructuring, as will be further discussed in section 3.1. All the major institutions give their clients access to remote/online services. Actually, 57.4% of the population declares to use the Internet to pay bills and make purchases. As regards account penetration, almost the 98% of the adult population has a bank account (including 97.6% of women, 84.7% of 15-24 year old young adults, and 97% of adults in the poorest 40% of households).⁵⁸

⁵⁷ DGPYME (DIRCE, 2014)

⁵⁸ Demirguc-Kunt, Asli, Leora Klapper, Dorothe Singer, and Peter Van Oudheusden. 2015. "The Global Findex Database 2014: Measuring Financial Inclusion around the World." Policy Research Working Paper 7255, World Bank, Washington, DC.

Number of Monetary Financial Institutions in Spain (2016)

	Spain
1. Total number of MFIs	296
a. National Central Bank	1
b. Total number of Credit Institutions	214
c. Total number of MMFs	31
d. Total number of other deposit taking corporations	50

Source: European Central Bank

Credit Institutions and Credit Financial Intermediaries in Spain and Castile-León (2016)

	Number of branches	Branches per 100,000 adults (15+ years old)
Spain	30785	77,73
Castile-León	2228	102,53

Sources: Instituto Nacional de Estadística (INE), Banco de España

As regards SMEs access to credit, 33.7% of the Spanish SMEs use bank products such as loans, credit lines and bank overdraft: the same trend can be observed in Euro area (June 2016), where credit lines, followed by self-financing (capital growth generated by the firm's own income), represent the main source of SME financing. Given the general decrease of the interest rate, banks are increasing the fees not linked to financing as well as the overall quantity of credit, which implies a higher request of collaterals. However, the digitalisation of the processes noticeably helps banks respond quickly to SMEs' requests for financing.⁵⁹

Spain occupies the 59th position in the ranking of 189 economies on ease of getting credit. Furthermore, it has a score of 7 out of 8 on the depth of credit information index and a score of 5 out of 12 on the strength of legal rights index, meaning that there is a very good level of credit information, but there is room for improvement for collateral and bankruptcy laws so as to facilitate access to credit.⁶⁰

In order to optimize the evaluation procedure, maximize credit operations, and minimize risk, Spanish MFIs adopted an analysis and scoring mechanism to classify individuals and businesses applying for a loan, line of credit, etc. and define the appropriate guarantees/collaterals for each operation.

⁵⁹ CEPYME, 2016. Boletín de Morosidad y Financiación Empresarial, nº9, July 2016.

⁶⁰ World Bank. 2016. Doing Business 2016: Measuring Regulatory Quality and Efficiency. Washington, DC: World Bank Group.

The scoring model is composed of different phases, which can be described as follows:

a. Identification of the applicant and type of operation

Applicant	
Type	Relation with the bank
<input type="checkbox"/> Self-employed <input type="checkbox"/> Self-employed (liberal professions) <input type="checkbox"/> SMEs	<input type="checkbox"/> Client <input type="checkbox"/> Non client
Type of operation	
<input type="checkbox"/> Commercial <input type="checkbox"/> Mid-term fixed or productive assets loan <input type="checkbox"/> Liquidity loan <input type="checkbox"/> Raw material loan	

b. Request for documents

Self-employed
a) Sociodemographic information b) Economic information: - Income (as employee and/or self-employed) - Expenses c) Information on the business activity
SMEs
a) Economic/financial information (annual accounts) b) Information on the business activity c) Information on the manager of the business
If the applicant is also a bank client
- Information on the bank products already used by the client - Risk information

c. Final evaluation, which depends on:

- a) The result of the client evaluation (repayment capability being the most important factor in the assessment)
- b) The characteristics of the financial product/s: amount, type of operation (loan, leasing, overdraft, etc.), term, percentage of the total investment, financial burden, etc.⁶¹

1.2. Financial services provided by the non-banking sector in the region

SMEs are more likely to use alternative external financing instruments, such as non-bank lending, in times of financial crises.⁶² Non-banking microfinance institutions represent one of the main alternative European SMEs resort to when they cannot access the traditional banking sector.

However, the lack of a regulatory framework for the Spanish microfinance sector can be considered as one of the main issues hindering the expansion of a model based on proper microfinance institutions.

In Spain, microfinance services are typically offered by a number of different institutions which collaborate to cover all the relevant business development areas: usually, banking institutions (among which Microbank currently stands out in terms of loan volume and geographical coverage) provide microloans, using their own resources, while Social Microcredit Support Organizations (SMSOs) – which can be either public or private organizations promoting self-employment and social inclusion – deliver Business Development Services (BDS) and act as intermediaries between banks and borrowers. Some SMSOs also have own microcredit funds and programmes, but in general the sector is struggling to survive, as the financial crisis made it very difficult to get funding. From this perspective, becoming regulated Microfinance Institutions (MFIs) would make it easier for these entities to access EU support, such as the Employment and Social Innovation (EaSI) Guarantee Financial Instrument.

In Castile-León, the *Centro Europeo de Empresas e Innovación* (CEEI Burgos) is one of the main organisations operating in the field of business incubation and development, implementing also microfinance programmes financed by public entities like Sodebur (*Sociedad para el Desarrollo de la Provincia de Burgos*) as well as providing guidance about funding opportunities, such as public funds and incentives. CEEI's activities will be further discussed in section 3.2.

⁶¹ Área de Pymes, Análisis del riesgo financiero en la Pyme, <http://www.areadepymes.com/?tit=analisis-del-riesgo-financiero-en-la-empresa&name=Manuales&fid=fh00002>

⁶² Casey, E. and O'Toole, C. (2014), "Bank Lending Constraints, Trade Credit and Alternative Financing during the Financial Crisis: Evidence from European SMEs", *Journal of Corporate Finance*, Vol. 27, pp. 173–193.

Although microcredit programmes are still relatively small because of the reasons illustrated above, there is a number of public initiatives to support SME development in Castile-León through economic support, incentives and subsidies.⁶³

1.3. “Unbankable” enterprises: main barriers for SMEs in accessing banking services.

SMEs in the euro area are usually more dependent on banks than larger enterprises due to their typically less clear balance sheets, less informative financial statements and shorter track records, which discourages potential investors.⁶⁴ A thorough study on SME access to finance conducted by the OECD shows that access to finance is problematic in many countries, especially in times of crisis, when informational asymmetries negatively influence the opportunities of getting funding. Moreover, the likelihood of accessing banking services is restricted also by agency risks, insufficient collateral, small transaction volumes as well as by firm size, ownership structure, innovativeness of the SME and industry in which they operate.⁶⁵

Over the last few years, financing conditions generally improved, especially with respect to the average interest rates charged to SMEs, although they remain tight and they are generally much more favorable for large enterprises than for SMEs.⁶⁶

According to the Spanish Confederation of SMEs (CEPYME), in 2015, 21% of the Spanish SMEs have experienced credit restrictions (compared to the 41% reported in 2012): this figure is relatively high, but it also includes the proportion of high-risk businesses which could not close the fiscal year with profits. In addition, 77% of SMEs declared to have obtained better credit conditions,⁶⁷ which is consistent with the trend described by the OECD.

As far as non-performing loans (NPL) are concerned, the ratio of NPLs to all loans varies considerably across Spanish banks and across firms of different size. Loans to SMEs are more likely to be non-performing than loans to large enterprises,⁶⁸ which further hinders SME access to finance and raises the unmet credit demand. However, the most recent data

⁶³ For a complete overview of the support programmes currently implemented, see http://www.ipyme.org/_layouts/15/ipyme/guiaayudas.aspx?CCAA=7, http://www.ceeiburgos.es/sites/default/files/subvencion_2016_PYMES.pdf and http://www.ceeiburgos.es/sites/default/files/ficheros-publicados/resumen_lineas_financiacion_emprendedores_y_pymes_2016_0.pdf.

⁶⁴ ECB (2014), “SME Access to Finance in the Euro Area: Barriers and Potential Policy Remedies”, Monthly Bulletin, July 2014, pp. 79–97.

⁶⁵ European Investment Fund, 2015. *Financing Patterns of European SMEs: An Empirical Taxonomy*, Working Paper 2015/30, http://www.eif.org/news_centre/publications/Financing%20patterns%20of%20European%20SMEs%20-%20EIF%20working%20paper%202015-30.pdf

⁶⁶ OECD (2015), *Financing SMEs and Entrepreneurs 2015: An OECD Scoreboard*, OECD Publishing, Paris.

⁶⁷ CEPYME, *Diagnóstico Financiero de la Empresa Española*, mayo 2016, <http://www.cepyme.es/wp-content/uploads/2016/06/VII-Diagno%CC%81stico-Financiero-presentacio%CC%81n-2015-2016.pdf>

⁶⁸ OECD (2015), *Financing SMEs and Entrepreneurs 2015*.

available show a decrease of both the SME NPL ratio – it fell from 27.3% in December 2014 to 21.3% in December 2015 – and the SME flow of NPLs.⁶⁹

2. Financial awareness of the population

Financial awareness is essential to encourage prudent behavior and make informed financial decisions. To raise financial awareness of the population, governments are encouraged to foster financial education, which can be defined as “the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being”.⁷⁰

2.1. Overindebtedness of the population and prevention measures

Spanish Law n. 22/2003 states that debtors are declared insolvent if they cannot meet, on an on-going basis, their financial commitments.⁷¹ Similarly, the Civic Consulting of the Consumer Policy Evaluation Consortium (CPEC), in a study conducted for the European Commission Directorate General for Health and Consumers (DG SANCO), specifies that “households are considered over-indebted if they are having – on an on-going basis – difficulties meeting (or falling behind with) their commitments, whether these relate to servicing secured or unsecured borrowing or to payment of rent, utility or other household bills. This may be indicated by, for example, credit arrears, credit defaults, utility/rent arrears or the use of administrative procedures such as consumer insolvency proceedings.”⁷²

According to the most recent available data (2011), 7.7% of the Spanish total population is in arrears on key commitments (e.g. mortgage, rent, utility bills, other loans, etc.), below the EU27 average of 11.4%; 27% of the population was under financial strain but not in arrears; 35.4% was unable to face unexpected financial expenses. In 2010, 27% of the respondents to the survey for the Eurobarometer 321 and 355 on poverty and social exclusion declared that they feel at risk of being over-indebted. In the same year, 32% of the households were considered financially vulnerable.⁷³

In 2008, Spain was considered as one of the countries without debt counselling services. These services are basically offered only by some consumer organizations and financial services

⁶⁹ Banco de España, 2016. Financial Stability Report, 05/2016. http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinancera/16/IEFMayo2016_Ingles.pdf

⁷⁰ OECD, 2015. Recommendation on Principles and Good Practices for Financial Education and Awareness, <http://www.oecd.org/finance/financial-education/35108560.pdf>.

⁷¹ Ley 22/2003, de 9 de julio, Concursal.

⁷² CPEC, 2013. The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact – Part 1: Synthesis of findings. http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf

⁷³ Ibid.

providers. On the other hand, Spain has introduced financial support to help unemployed pay their mortgage.

Figure 35: Debt Advice Service Providers

	Type of stakeholder	Services provided	Administrative level(s) of operation	Target groups	Costs of services	Sources of funding
Asociación Murciana de Consumidores y Usuarios	Consumer organization	Personalised debt advice face-to-face, by telephone, email/online chat;	Regional	Over-indebted households; Households at risk of becoming	Partly free/partly paid services	User fees; Public funding
		Facilitating informally brokered arrangements between debtor and creditors;		over-indebted; Households with specific debt problems		
		Facilitating formal procedures for debt				
		settlement that do not take place in court;				
		Facilitating legal procedures in court.				
ASGECO	Consumer organisation	Personalised debt advice face-to-face, by telephone, email/online chat;	N/A	N/A	N/A	User fees; Public funding
		Facilitating informally brokered arrangements between debtor and creditors;				
		Facilitating formal procedures				

<p>Plataforma de Afectados por la Hipoteca (PAH)</p>	<p>Other NGO/charity</p>	<p>for debt settlement that do not take place in court.</p> <p>Personalized debt advice face-to-face, by telephone, by email/online chat;</p> <p>Printed information;</p> <p>Facilitating informally brokered arrangements between debtor and creditors;</p> <p>Facilitating legal procedures in court;</p> <p>Other services.</p>	<p>National; Regional; Local</p>	<p>Over-indebted households;</p> <p>Households with specific debt problems.</p>	<p>All services free of charge</p>	<p>Funding from charity/other voluntary sources</p>
<p>ADICAE, Asociación de Usuarios de Bancos, Cajas y Seguros de España</p>	<p>Consumer organization</p>	<p>Personalized debt advice face-to-face, by telephone, by email/online chat;</p> <p>Web-based tools;</p> <p>Printed information;</p> <p>Facilitating informally brokered arrangements between debtor and creditors</p>	<p>National</p>	<p>Over-indebted household; Households at risk of becoming over-indebted; Households with specific debt problems; Specific age groups; Specific social groups</p>	<p>Partly free/partly paid services</p>	<p>User fees; Public funding</p>

Source: CPEC

2.2. Level of financial literacy and education.

In 2008, Banco de España and the CNMV (*Comisión Nacional del Mercado de Valores*, the Spanish securities supervisor) elaborated the *Plan de Educación Financiera* (Financial Education Plan), which was then revised for the period 2013-2017. According to the Spanish Securities Markets Law 24/1988, CNMV has the role to protect investors: as a consequence, the *Comisión* fosters financial education as a tool to raise investors’ awareness. Similarly, the Spanish central bank promotes financial education as an element facilitating the stability of the financial system.

The Ministry of Economy and Competitiveness coordinates the relevant activities related to financial education and literacy. The main target groups of the Spanish financial education strategy are: students, young people, working-age adults, elderly people (including retired and retirees) and migrants. Regular monitoring of the evolution of financial literacy of the population will be carried out through periodic surveys.

To make the Plan effective, several collaboration agreements with banking industry associations, consumer associations, foundations, etc. were signed to develop and promote awareness and educational programmes, to design and conduct "training the trainers" programmes, to develop contents for the website managed by the financial supervisors, and to disseminate informative materials amongst their clients and staff. Private companies may submit materials to be used in the development of financial education activities: if such materials comply with the Plan and the established quality standards, they are allowed to use of the logo of the national strategy. The portal ‘finanzasparatodos.es’ aims to “help people’s personal economy daily management” through a series of tools, including a “survival financial kit”, and provides teachers and trainers with (i) teaching resources, guidelines and recommendations to teach financial education in the classroom, (ii) the curricular areas related to financial education, (iii) games, workshops, etc. (see next Figure).⁷⁴

Figure 36: Finanzasparatodos portal contents

	Info about financial	Glossary of financial terms	Info about life stages/events	Calculators	Tools to compare financial products	Games	Videos	Quiz	Other
finanzasparatodos.es	✓	✓	✓	✓		✓			

Source: OECD

As a result of the Plan, financial education courses have been introduced in schools with promising results. The Organic Law 8/2013 for the improvement of the education quality has introduced financial education in the school curricula of primary and secondary schools. In primary school, children will learn basic concepts related to the value of money, saving,

⁷⁴ <http://finanzasparatodos.es/>

personal budget and responsible consumption. In secondary school, financial education contents will be integrated in economics.⁷⁵

In addition, some savings banks developed partnerships with local schools and/or universities to develop and manage a financial education programme for 14-25-year old students. This initiative, shared with other European banks, is called European Stock Market Learning and consists of the online management of a virtual portfolio of securities over a 10 week period to help youngsters understand economics and markets, and experience portfolio investment. More than 45,000 teams all over Europe take part each year.⁷⁶

3. Measures to increase access

As mentioned earlier, the microfinance sector in Spain is underdeveloped compared to the rest of Europe. The unmet demand for financing is big and, considering the current difficult job market, people would try to create their own jobs, rather than look for one. Therefore, there is a clear need to expand access to finance to people wanting to start their own business and exit from financial and/or social exclusion.

3.1. Regional policies, strategies to prevent financial exclusion

The financial banking sector restructuring carried out over the last years has entailed the closure of about 10,000 bank branches and the elimination of the Spanish saving bank system: according to professor Joan Ramon Sanchis (University of Valencia), this process led to the predominance of productivity over the social dimension of the banking services, which has exacerbated the financial exclusion of the most vulnerable segments of the population. Currently, 2.6 million people in Spain are considered financially excluded (55% of whom are women) and 12.1 million under-served.

Financial and social exclusion are the main concerns of ethical financial entities, which actively fight against them through their training and educational programmes, as well as creating

⁷⁵ These measures also comply with the OECD's "Recommendation on Principles and Good Practices for Financial Education and Awareness", which, among other things, states the following:

- Governments and all concerned stakeholders should promote unbiased, fair and coordinated financial education.
- Financial education should start at school, for people to be educated as early as possible.
- Financial education should be part of the good governance of financial institutions, whose accountability and responsibility should be encouraged.
- Financial education programmes should focus particularly on important life-planning aspects, such as basic savings, debt, insurance or pensions.
- Programmes should be oriented towards financial capacity building, where appropriate targeted on specific groups and made as personalised as possible.
- National campaigns, specific Web sites, free information services and warning systems on high-risk issues for financial consumers (such as fraud) should be promoted.

OECD, 2015. Recommendation on Principles and Good Practices for Financial Education and Awareness, <http://www.oecd.org/finance/financial-education/35108560.pdf>.

⁷⁶ OECD (2016), Financial Education in Europe: Trends and Recent Developments, OECD Publishing, Paris.

specific lines of credit, microcredit programmes and cooperatives with the aim to support entrepreneurship and foster inclusion.⁷⁷

There is a direct correlation between the enterprise size and the volume of external financing: this is a fact worth mentioning, considering that 95.9% of the SMEs in Spain and 96.5% in Castile-León are microenterprises with less than 10 employees.

The European Central Bank announced two series of targeted longer-term refinancing operations (TLTROs) in June 2014 and March 2016 to further encourage credit institutions' lending to real economy: they are long-term funding at attractive conditions (0.25% interest rate) that the ECB offers to banks with the explicit condition that the latter will use the funds to finance SMEs and households. This programme is aimed at increasing the competition among credit institutions and offering better financing conditions to the clients, which should facilitate financial inclusion.

Furthermore, the SME Initiative was launched in Spain in 2015: it is co-financed by the Kingdom of Spain, the European Commission and the EIB Group (i.e. the European Investment Bank and the European Investment Fund). The initiative is expected to generate at least EUR 3,200 million of SME financing in Spain over the next few years. Castile-León is one of the regions contributing to the SME Initiative. The EIF does not finance entrepreneurs or SMEs directly, only via financial intermediaries.⁷⁸

Finally, in July 2016, EIB and Castile-León Regional Government signed a 130 million Euro loan to invest in strategic sectors and to finance businesses within the region in order to strengthen production and encourage job creation through innovation and internationalization. The regional government will invest these funds in research and innovation, conservation and improvement of cultural and natural resources, renewable energy, tourism and vocational training.⁷⁹

3.2. Regional initiatives to improve access to microfinance.

As illustrated in section 1.2, the microfinance sector in Spain is still under-developed. Besides the aforementioned MicroBank and other microfinance programmes implemented by SMSOs, it seems that now microfinance could gain momentum: some banks (e.g. Banco Popular and its "*Apostamos por ti*" project) are creating specific microcredit lines complemented by business support services, training and mentoring,⁸⁰ and new microfinance institutions have been created (for example, Fundación Oportunitas in Barcelona).

⁷⁷ Oiko Credit (2015), *Exclusión social y exclusión financiera, un mal endémico de nuestra sociedad*, <http://catalunya.oikocredit.es/k/es/n5690/news/view/133048/59957/exclusion-social-y-exclusion-financiera-un-mal-endemico-de-nuestra-sociedad.html>.

⁷⁸ EIF, The SME Initiative Spain, http://www.eif.org/what_we_do/guarantees/sme_initiative/smei_spain/index.htm

⁷⁹ EIB (2016), EIB and Castilla y León Regional Government sign a EUR 130m loan to drive economic growth, competitiveness and jobs in the region, <http://www.eib.org/infocentre/press/releases/all/2016/2016-187-el-bei-y-la-junta-firman-un-prestamo-de-130-millones-para-impulsar-el-crecimiento-economico-la-competitividad-y-el-empleo-en-castilla-y-leon.htm>

⁸⁰ <https://www.comunicacionbancopopular.es/nota-de-prensa/popular-lanza-microcreditos-apostamos-por-ti/>

In order to raise awareness about microfinance as a tool to fight social exclusion and unemployment and improve access to finance, the European Microfinance Network and the Microfinance Centre celebrate every year, on the 20th of October, the “European Microfinance Day”, during which a number of workshops, debates, and events take place at local level across the EU thanks to the collaboration with member organisations.

At regional level, as mentioned in section 1.2, access to microfinance for SMEs is particularly encouraged by the joint action of Sodebur and CEEI Burgos, which grant microloans up to 25,000 Euros to create new businesses or expand and improve existing ones. Such businesses must be located in less than 20,000 inhabitants towns in the province of Burgos, the loans can cover up to 70% of the total investment and are granted at very accessible conditions (1.5% fixed interest rate, no collateral required). CEEI also offers a wide range of specialised services to support microentrepreneurs in the definition, development and improvement of their business plans and operations.⁸¹

⁸¹ <http://www.ceeiburgos.es/servicios/servicios-para-emprendedores>

CROATIA

Financial exclusion and access to microfinance

1. Overview on regional financial services

1.1 Short overview on the available banking services in the region

Geographical coverage of banking services in the Republic of Croatia is related to the concentration of population found in a particular area. The information show that the City of Zagreb dominates in the number of branches and ATMs while, for example, Lika Senj County has the smallest number of branches, which is supported by the data from the following table:

Table 9: Territorial dispersion of bank branches and ATMs

County	2012		2013		2014	
	No. of bank branches	ATMs	No. of bank branches	ATMs	No. of bank branches	ATMs
Zagreb County and City of Zagreb	297	1.158	282	1.163	277	1.193
Krapina Zagorje County	29	97	29	97	29	100
Sisak Moslavina County	35	109	38	107	33	111
Karlovac County	30	93	30	100	28	103
Varaždin County	41	132	38	130	39	130
Koprivnica Križevci County	33	68	28	66	27	66
Bjelovar Bilogora County	25	70	24	70	25	72
Primorje Gorski Kotar County	108	374	104	378	101	399
Lika Senj County	18	56	19	62	17	65
Virovitica Podravina County	27	44	26	45	30	45
Požega Slavonia County	25	51	24	46	26	48
Brod Posavina County	31	76	31	76	30	79
Zadar County	58	227	55	230	51	243
Osijek Baranja County	78	202	74	199	71	202
Šibenik Knin County	43	144	40	153	42	163
Vukovar Srijem County	30	112	31	109	30	110
Split Dalmatia County	149	466	150	475	144	505
Istria County	108	343	106	351	105	375
Dubrovnik Neretva County	59	175	61	180	59	198
Međimurje County	30	86	30	86	28	89
Total	1.254	4.083	1.220	4.123	1.192	4.296

Source: Bank Bulletin, Croatian National Bank (HNB), 2015

Data analysis from the table regardless of the county, and especially in the total, show a tendency of gradual decline in the number of bank branches and an increase in the number of ATMs, which in most cases depends on the location.

The biggest number of bank branches at the end of 2014 were located in Zagreb County and the City of Zagreb with almost a quarter of the total number of branches (23.2%). The main reason for this is a high concentration of population in the capital area. In Koprivnica-Križevci County a trend of reducing number of bank branches can be noticed as well as stagnation in the number of ATMs.

According to the last Census 2011⁸², Croatia has 4,284,889 inhabitants. During 2014, the total number of legal-age (18 year old) population was around 3,431,132 people, and they can legally open bank accounts regardless of their income. According to the last Census Koprivnica Križevci County has 113,688 inhabitants out of which 91,467 are of legal-age. Total number of bank accounts⁸³ in the same period was 5,963,901 of which 436,163 were business, and 5,527,758 were citizens accounts. According to that information, in Croatia there are 1738 bank accounts per 1,000 residents.

During the same period there were 4,296 bank branches on 3,431,132 people which is a total of 125 bank branches per 100,000 inhabitants. In Koprivnica Križevci County the number of adult population is under the set indicator of 100,000 people, so there are 27 bank branches per 91.467 inhabitants.

Banking services are related to receiving cash deposits and granting loans and other placements from these funds for own account, as well as issuing means of payment in the form of electronic money and providing other financial services such as: issuance of guarantees or other commitments, factoring, financial lease, crediting, trading for own account or on behalf of a client and other services.

One of the most important service that banks provide to their clients is granting loans. Each credit institution prescribes its documentation and conditions as the basis for determining whether the person seeking a loan is creditworthy i.e. assesses his creditworthiness.

The crediting of business projects requires the implementation of certain procedures for loan approval. Alongside the application for the loan, the entrepreneur presents their business ideas with a business plan or an investment study that provides information about the viability of the entrepreneurial venture.

⁸² Census of population, households and dwellings 2011, Croatian Bureau of Statistics, Zagreb 2013

⁸³ Information about the numbers of bank accounts, Croatian National Bank, Zagreb 2013

To determine the creditworthiness and credit risk of a client, the bank will first of all, analyze its financial reports, the balance sheet and the income statement.

Alongside the financial reports banks also use different indicators of creditworthiness, such as:

- liquidity of the company that indicates whether the company is able to settle short-term liabilities which is analyzed through coefficients of general and accelerated liquidity,
- activity of the enterprise, revolution coefficient of total and short-term assets, days required to get payment from customers, days required to pay for obligations and days of inventory turnover,
- financial stability, or the number of years during which a company in a situation of zero growth could settle the newly created credit liability and the coefficient of self-financing i.e. what risk percentage is handled by the entrepreneur and what percentage is handled by the creditor,
- profitability or the ability of achieving better results with lower investments, the level of the gross margin, and the effectiveness of assets in generating profits.

1.2 Financial services provided by the non-banking sector in the region

Alongside the banking sector, financial services are also provided by participants from the non-banking sector. In Croatia this sector consists of insurance and reinsurance companies, leasing companies, pension fund management companies and investment fund management companies.

Insurance companies conclude contracts with their clients by which they are obliged to compensate the client, in the form of payment, in the events of financial losses covered by the insurance. For this service the client is required to pay a premium to the insurance company. Leasing companies, for an agreed fee, acquire and deliver real estate or vehicles to their clients for a certain period of time. Pension fund management companies specialize in financial management of pension and investment funds in order to increase the value of the fund's assets in order to be able to provide pension payments to retired fund members. Investment fund management companies are institutional investors who collect funds from the general public and place them in short or long-term investment funds, abiding by the principles of safety, profitability and diversification of risk.

Their headquarters are located in Zagreb while business in other towns is conducted through subsidiaries and by licenced agents. The study found no measures or conditions for the use of

non-banking sector products by SMEs and they can use their products according to free-market rules.

1.3 “Unbankable” enterprises: main barriers for SMEs in accessing banking services

Although there are many ways of crediting enterprises in accordance with the Entrepreneurship Development Strategy of the Republic of Croatia for the Period 2013-2020⁸⁴, microfinance in Croatia is very limited. Although most of the available microfinance comes from the banking sector (82 %), loans are mainly given to medium-sized companies, and the share of micro and small enterprises in the total loan portfolio amounts to about 8% (less than three billion euros). EIF research data show that micro and small enterprises very often have difficulties with fulfilling procedures and conditions required for microfinancing, and entrepreneurs also often have difficulty negotiating the loans and required amounts.

Problems related to micro-finance are:

- lack of guarantees,
- range of banking products and services,
- required credit documentation,
- interest rate amounts,
- lack of information about available products.

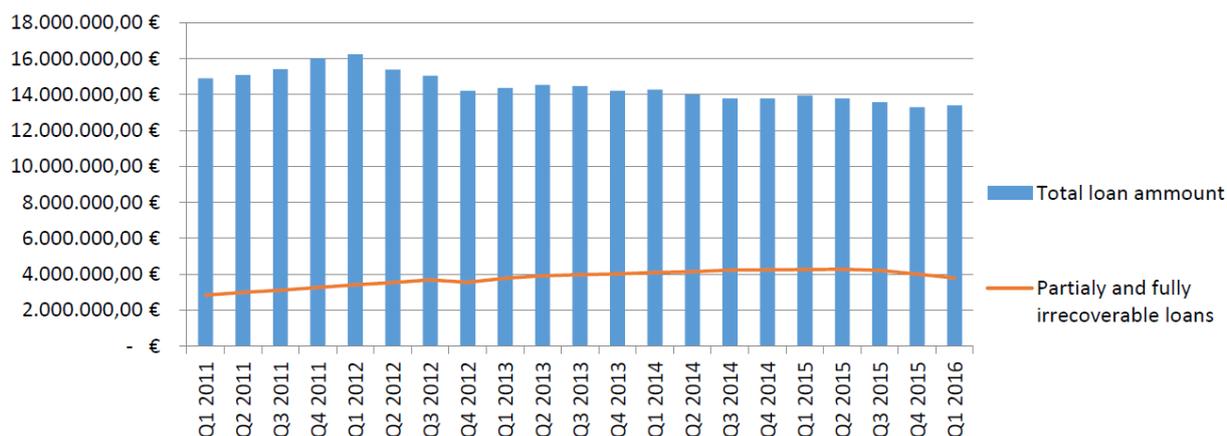
The biggest problem with bank loan approval is the lack of credit guarantees and in Croatia credit institutions accept the following as collateral:

- pledge or fiduciary transfer of property ownership with property insurance,
- bills of exchange and promissory notes,
- bank guarantees,
- HAMAG BICRO guarantees up to 80% of loan amount,
- in cases of smaller loans two creditworthy guarantors are required;
- other insurance instruments.

⁸⁴ Source: <http://www.europski-fondovi.eu/sites/default/files/dokumenti/Strategy-HR-Final.pdf>

Due to unfavorable credit conditions in Croatia there is a high proportion of loans that are non-recoverable. The next chart shows the share of partially and fully irrecoverable loans in the total amount of loans issued to companies on a quarterly basis during the 2011-2016 period.

Figure 37: The share of irrecoverable loans in total issued loans



Source: Credit quality by sectors, Croatian National Bank (HNB) Statistic, 2016

The average amount of loan per quarter for a given period was 14,463,661.39 EUR, and the biggest amount of loan issued was reached in Q1 2012 in the amount of 16,246,891.31 EUR while the lowest amount of issued loans was realized in Q4 2015. The average amount of partially and fully irrecoverable loans during the same period was 3,774,011.32 EUR. The lowest level of irrecoverable loans in Q1 2011 was 2,825,236.04 EUR, and with continuous growth reached its maximum in Q2 2015 in the amount of 4,270,221.59 EUR. The average share of partially and fully irrecoverable loans per quarter was 26.29%. The lowest share of irrecoverable loans in total loans was in Q1 2011, with a share of 18.96%, followed by a continuous growth of irrecoverable shares reaching a maximum in Q3 2015, when 31.08% of the total loan amount was consist of partially or fully irrecoverable loans⁸⁵.

2. Financial awareness of the population

2.1. Overdebtness of the population and prevention measures

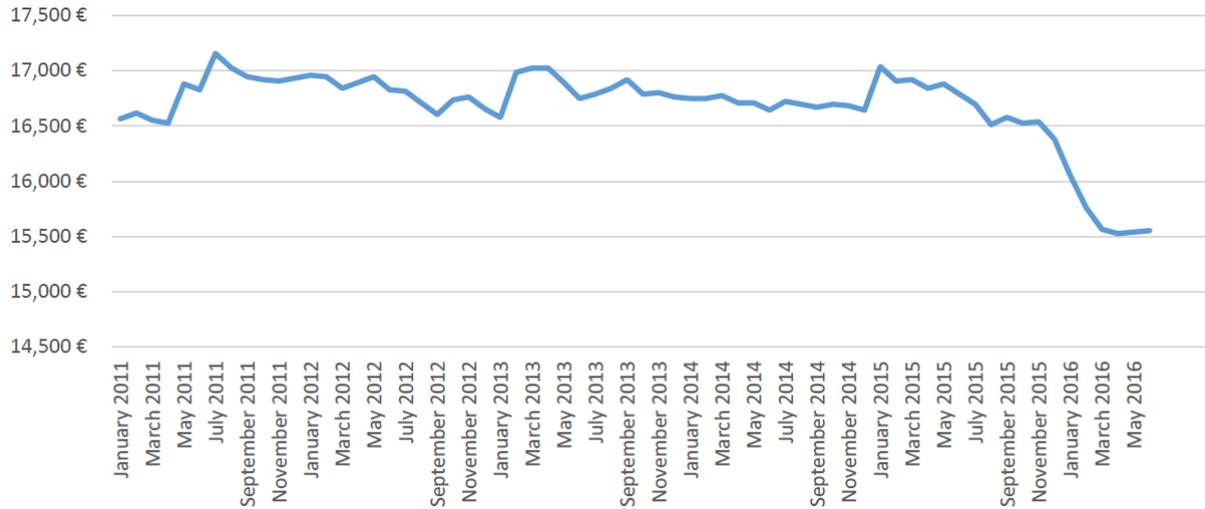
In the conditions of global financial crisis, rising unemployment was the reason for growth of citizen debt and inability to settle credit obligations. Loss or reduction of income caused the inability of citizens to pay their loans and often lead to forced collection of credit obligations.

⁸⁵ <https://www.hnb.hr/en/statistics/statistical-data/credit-institutions/indicators-of-credit-institution-operations>

According to the Credit Enforcement Act, two-thirds of the average net salary in Croatia is exempt from enforcement if it is carried out on salary of the debtor. Furthermore, half of the average net salary is exempt, if enforcement is carried out in order to collect claims based on statutory maintenance, damages caused by health distortions or loss of working ability and damages for lost support due to the death of the care provider. The only enforcement exception is for the compulsory collection of the amount for child support, and then one quarter of the average net salary is exempt. If the debtor receives a salary smaller than the average net salary in Croatia, the exempt amount equals two-thirds of the debtors' salary. If enforcement is carried out in order to collect claims based on statutory maintenance, losses caused by damage to health, loss of working ability or lost support due to the death of a care provider, then half the net salary of the debtor is exempted.

According to the Croatian National Bank and The Ministry of Finance, in early 2011, citizen debt amounted to 16.56 billion EUR. During 2011, citizen's debt was at its highest level in the past five years, and reached 17.16 billion EUR in July. In the years following 2011, citizen debt fluctuated around an average of 16.8 billion EUR, and reached a new high of 17.03 billion EUR in January 2015. According to the data, it is evident that after reaching its new maximum, through the year 2015, citizen debt began to rapidly decline and this trend has continued in the following year. In late June 2016, citizen debt level dropped to the amount of 15.55 billion EUR⁸⁶.

Figure 38: Citizen debt (billions of euros)



Source: Croatian National Bank and The Ministry of Finance

⁸⁶ http://www.nhs.hr/gospodarstvo/pokazatelji/zaduzenost_gradjana/

The fall of citizen debt is the result of Measures for prevention of over-indebtedness of citizens based on education and counseling of the population, and also partly of the legal protection of citizens who enter into credit debt. In the year 2015, new legislation was introduced: Consumer Protection Act (NN 14/14, 110/15) and the Consumer Credit Act (NN 52/16).

In order to prevent over-indebtedness of citizens, Croatian Banking Association (HUB) with its member banks organized a series of free interactive workshops on managing personal finances, titled "How to Balance Income and Expenses?" for Croatian citizens. The project was launched in cooperation with the UNDP in 2006 and is still active. The workshops are free for all citizens, last about 90 minutes and require no prior preparation. Their purpose is to help citizens in planning and management of personal finances.

In order to prevent over-indebtedness of citizens, Counseling service for personal and family finances "Život u plusu" helps over-indebted citizens to overcome difficulties in personal and family finances. Services are free and help citizens who are in the red on their bank accounts to achieve the financial plus for better stability and security.

2.2. Level of financial literacy and education

The Economic Institute in Zagreb has specialized for scientific and development research in the field of economics. This institute carries out research programs of strategic interest in the Republic of Croatia and in 2015 there were announced the results of the financial literacy test in Croatia.

By conducting the survey via the telephone respondents were tested in the following fields:

- Financial knowledge – questions about concepts such as time value of money, simple and compound interest, risk, investment return, inflation and diversification of savings with a maximum of 8 achievable points,
- Attitude and belief – which consisted of the following claims "Money exists to be spent", "I find more pleasure in spending money than in long-term saving" and "I try to live for today, with no thought for tomorrow" that respondents assessed on a scale of 1 to 5,
- Financial behavior - issues relating to types of behavior, such as whether they can afford something before buying, paying the bills on time, overseeing finances, setting long-term financial goals, etc. with a maximum of 9 achievable points.

The combined measure is made by summing all these components and it shows the level of financial literacy with possible values from 1 to 22. A higher score in all components indicates greater rationality and levels of knowledge.

Testing was conducted on a sample of 900 people representative by age (18-65), gender, region, size of the settlement and education. The survey was adapted to Croatian national conditions based on the OECD methodology for measuring financial literacy.

Table 10: Measure of financial literacy by region

Measure of financial literacy	Region		
	North-West Croatia	Central and East Croatia	Adriatic Croatia
Combined measurements	14,27	13,92	13,84
Knowledge component	5,56	5,24	5,33
Attitude and belief component	3,23	3,20	3,07
Behavior Component	5,43	5,44	5,39

Source: Financial literacy of Croatian citizens, Economic Institute, 2015

The highest levels of financial literacy were shown by respondents from North-West Croatia, which for the most part knew the offered terms. In the component of attitudes and beliefs the highest level of knowledge was shown by respondents from Central-East and North-West Croatia where, according to the survey people make more plans for the future and have a careful attitude toward money.

Table 11: Measure of financial literacy by age Measure of financial literacy

Measure of financial literacy	Respondent age				
	18-24	25-34	35-44	45-54	55-65
Combined measurements	13,35	13,71	13,95	14,27	14,47
Knowledge component	4,92	5,25	5,29	5,60	5,60
Attitude and belief component	3,07	3,22	3,26	3,10	3,18
Behavior Component	5,21	5,35	5,38	5,42	5,65

Source: Financial literacy of Croatian citizens, Economic Institute, 2015

Considering the results according to age, in the case of the combined measure and all individual components it is shown that the older the age group of the respondent is the higher the level of financial literacy. These observations are supported by similar results from most of the countries in which such research is conducted.

Table 12: Measure of financial literacy by level of education

Measure of financial literacy	Level of education		
	Primary school of under	High school	Higher education
Combined measurements	12,62	13,65	15,23
Knowledge component	4,45	5,21	6,04
Attitude and belief component	3,05	3,18	3,19
Behavior Component	4,97	5,25	5,96

Source: Financial literacy of Croatian citizens, Economic Institute, 2015

Survey results support the theory that higher levels of education result in higher financial literacy. Despite that, the necessity of higher education does not appear to be crucial because some individuals from lower education groups did achieve high financial literacy scores.

Low correlation between financial knowledge and financial behavior shows that Croatian citizens, even though they are aware of the benefits, as well as financially responsible behavior, do not apply this knowledge in everyday life, so it would be desirable that all future education positively affected everyday financial behavior.

Since 2006, the Croatian Banking Association (HUB) and its members have implemented a number of different projects and educational programs to continuously promote the importance of financial literacy, which has wide social benefits. During 2015, almost 6000 people, of which 4500 were young people and children, took part in educational activities of HUB and member banks to marking the European Money Week. Various educational materials for young people, such as a training table for planning personal finances in Excel were made, presentation of useful mathematical operations for conducting personal finances, presentations on the basics of behavioral economics adapted for high school students and teachers, as well as a brochure intended for parents, which educates them at what ages children can and should be thought about finances.

In 2016, the Croatian Banking Association created "Financial Guide for Young People", educational material that provides young people with information on easier management of personal finances and prepares them for important life milestones like going to college, first employment, purchase of house or car, wedding, birth of a child or retirement.

3. Measures to increase access on regional and national level

3.1. Regional policies, strategies to prevent financial exclusion

The Entrepreneurship Development Strategy of the Republic of Croatia for the Period 2013-2020 was made in compliance with the Economic Program for the Republic of Croatia 2013 with the aim of strengthening the entrepreneurial potential and improving entrepreneurial culture. In order to achieve the set objectives, the following strategic goals were defined: improving economic performance, improving access to finance, promotion of entrepreneurship, improving entrepreneurial skills and improving of the business environment.

Achieving the second strategic goal – improvement of access to microfinance is planned through the development of various financial opportunities for SME businesses and by removing the financial gap. In order to achieve this strategic goal there are planned certain strategic measures: increasing the supply of microfinance and other initiatives to improve access to finance for starting a new businesses and by alleviating problems that SMEs face in their early life, by developing new forms of financing for start-ups and development of small business (investment share capital, venture capital and business angels) and support for small businesses to ensure the use of financial opportunities.

Other strategic documents related to promotion and development of entrepreneurship⁸⁷:

- Women Entrepreneurs Development Strategy of the Republic of Croatia for the Period 2014–2020
- Cluster Development Strategy of the Republic of Croatia for the Period 2013–2020
- Innovation Encouragement Strategy of the Republic of Croatia for the Period 2014-2020
- Smart Specialization Strategy of the Republic of Croatia for the Period 2016–2020
- Rural Development Programme of the Republic of Croatia for the Period 2014-2020
- Operational Programme Effective Human Potential 2014–2020
- Operational Programme Competitiveness and Cohesion 2014 – 2020
- Rural Development Strategies of the Republic of Croatia for the Period till the end of 2020

⁸⁷ <http://europski-fondovi.eu/strateski-dokumenti-republike-hrvatske-2014-2020>

3.2. Regional initiatives to improve access to microfinance

In Koprivnica Križevci County and, in accordance with the current strategic document - County Development Strategy and Strategic Objective 1 Competitive economy, Measure 1-3 Development Support to SMEs, Measure 1-3-3 Development of Financial Instruments for

Support of Economic Activity, local and regional self-government with a series of measures seek to encourage small and medium enterprises through the provision of favorable sources of financing for economic activities. Koprivnica Križevci County as a unit of regional self-government has for many years subsidized interest on business loans in the amount of 1% for the manufacturing sector, 2% for services, and an additional 1% for women entrepreneurship. Through a credit line called "Credit to Success" in the Koprivnica Križevci County during 2014, 4,224,396 EUR in loans to 28 businesses were approved, while in 2015 2,635,843 EUR in loans to 13 businesses were approved. City of Koprivnica got involved in the program "Credit to success", under which interest on business loans were subsidized by 1% for the manufacturing sector and 1% for the services sector, with the aim of creating better conditions for borrowing to SMEs in the Koprivnica area. City of Križevci offers craftsmen, SMEs, cooperatives, profit institutions and family farms loans with subsidized interest rates by 2.5 % per year. The above mentioned programs are implemented through public calls for the promotion of entrepreneurship, at County and City levels.

On the national level, the Croatian Agency for SMEs, Innovation and Investments (HAMAG BICRO) since 2013 conducts a favorable credit program intended for existing micro- economic subjects operating up to 24 months and entrepreneurs who plan to start their own business.

Loan features are⁸⁸:

- loan is intended for investment into fixed and working capital,
- minimum loan amount is 1,300.00 EUR, with a maximum of 15,500.00 EUR,
- annual interest rate is 0.99%,
- repayment period up to 5 years, including a 6 month grace period,
- collateral – debenture.

Activities to encourage entrepreneurship by HAMAG BICRO, during the last three years, resulted in providing 1,360,558.00 euros of loans to 112 micro and small enterprises. Activities

⁸⁸ <http://www.hamagbicro.hr/mikrokreditiranje/>

will continue in the period 2016-2018 and HAMAG BICRO through its new micro and mini credit lines plans to co-finance interest rates on business loans⁸⁹.

Microcrediting with EU support is implemented by the Croatian Bank for Reconstruction and Development (HBOR) in cooperation with commercial banks that have accepted cooperation within the Program. The aim of the program is to finance micro-entrepreneurs for the purpose of self-employment, establishment of crafts and LTDs, modernization and expansion of existing businesses and an increase in the number of newly created jobs.

Loan features are⁹⁰:

- loan is intended for investment into fixed and working capital,
- maximum loan amount is 25,000.00 euros in HRK equivalent,
- repayment period of 5 years, including a 1 year grace period,
- variable interest rate based on HBOR management decision,
- collateral – debenture.

⁸⁹ <http://www.hamagbicro.hr/mikrokreditiranje/dodijeljeni-mikrokrediti/>

⁹⁰ <http://www.hbor.hr/new-micro-loans-with-eu-support>

POLAND

Financial exclusion and access to microfinance

1 Information about regional financial services

1.1 A brief survey of banking services available in the region

Banking services are available in the area of the whole Świętokrzyskie Voivodeship. In the 21st century, the number of branch offices of commercial banks has increased, especially in medium-sized and large cities. In the case of small towns, cooperative banks may have a great significance, but there are still more and more branches of large banks. Remote banking services are on a high level in the region. As part of services provided by banks, entrepreneurs have access to:

- Internet banking,
- Terminal banking,
- Telephone banking.

In the second decade of the 21st century, mobile banking using mobile phone and tablet applications is gaining ever more importance. Such devices make it possible to use financial services everywhere provided that there is access to Internet. Thanks to the improved coverage provided by network operators, in 2016 one can log into one's banking account practically anywhere.

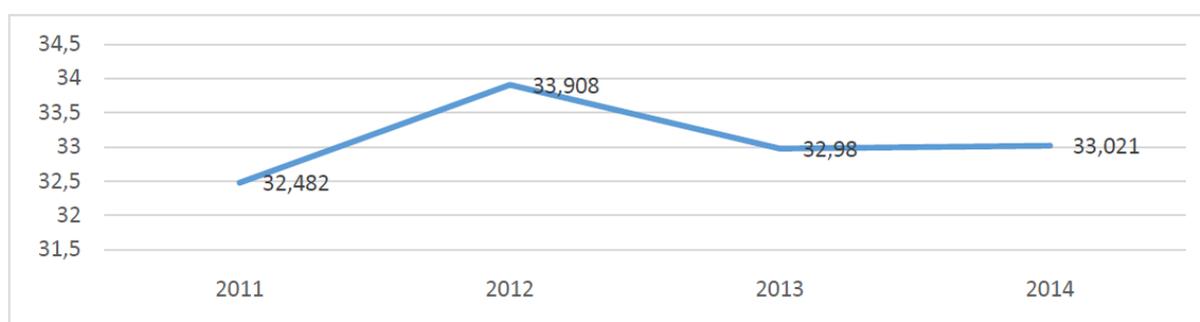
The requirements for gaining access to a credit product for entrepreneurs are related to the risk incurred by the lender. Bank employees assess risk in accordance with the specific instructions adopted by a given entity for a particular type of credit. The instruction contains a description of activities to be performed starting from the first visit until the complete repayment of a credit. It discusses such issues as, inter alia, the requirements for customers, form of reports on the activities of a credit inspector or way of making calculations to establish the situation of the borrower. The documents required by banks include a balance sheet, profit and loss account, extract from the commercial register, the current opinion of the bank in which the enterprise has its account, certificate of no tax and social insurance arrears and certificate on the current amount of the enterprise's liabilities. Based on all information gathered, a bank assesses the current creditworthiness of enterprises that apply for a credit and conducts preliminary selection of potential borrowers. The second part of the documentation specifies the amount and intended purpose of the credit and possible benefits for the enterprise. The next part is devoted to the options and forms of repayment - the future

creditworthiness. The last part of the documentation concerns credit securities. All the data collected by the bank are verified. Subsequently, credit-scoring is performed, i.e. the situation of the client is analyzed in points. If the potential borrower has a score satisfying the bank, an agreement will be concluded.

According to the report entitled "Innowacje w bankowości dla firm", the number of companies in the SME sector with access to e-banking is rising. In the second quarter of 2013, the number of companies functioning in this sector in Poland that made an active use of e-banking amounted to almost 1.1 million enterprises.

According to Global Financial Development Report: Financial Inclusion, in 2011, 70.2% of Poles above 15 years of age had bank accounts, a relatively small number in comparison to, for instance, France, where the indicator is 97%. The relatively low value of this indicator for Poland is related to the fact that a large proportion of young people and most students do not feel the need to have their own bank account. The number of banking establishments per 100 thousand adults over the years 2011–2014 was somewhat volatile. The decline in the value of this indicator was related to the merger of banks following which rival branches were liquidated.

Figure 39: Number of banking establishments per 100 thousand adults, Poland, 2011–2014



Source: Own elaboration based on The World Bank, www.data.worldbank.org

According to the latest published data (i.e. for 2009), the percentage of companies with a credit line in Poland was 50.10%. In the case of companies employing from 5 up to 19 persons, the value amounted to 47.50%.

1.2 Financial services provided by the non-bank sector in the region

Non-bank sector entities that provide services in the scope of financing in the Świętokrzyskie Voivodeship include primarily

- Loan companies granting so-called payday loans;

- Credit and savings unions (SKOK);
- Microfinancing sector entities:

o Świętokrzyski Fundusz Poręczeniowy Spółka z ograniczoną odpowiedzialnością (a surety fund),

o Fundacja Rozwoju Regionu Pierzchnica (Foundation for the Development of the Pierzchnica Region),

o Fundusz Pożyczkowy Województwa Świętokrzyskiego spółka z ograniczoną odpowiedzialnością (a loan fund),

o Ośrodek Promowania i Wspierania Przedsiębiorczości Rolnej in Sandomierz (Centre for the Promotion and Support of Agricultural Entrepreneurship in Sandomierz),

o Krajowe Stowarzyszenie Wspierania Przedsiębiorczości (National Association for Entrepreneurship Support),

o Agencja Rozwoju Regionalnego in Starachowice (Regional Development Agency in Starachowice).

Both loan companies, and credit and savings unions have their offices in the Świętokrzyskie Voivodeship. There are not many microfinancing sector entities but they provide services to interested parties from the whole region. As banks, non-bank sector entities also offer remote access to Internet services. Due to the significantly lower scale of their activity, they do not have yet well-developed mobile phone and tablet applications, but it may be expected that they also will introduce such customer conveniences soon.

The procedure of credit risk assessment in credit and savings unions is carried out in a very similar way as in banks; entrepreneurs have to complete a complex documentation which is the basis for awarding points. If a potential entrepreneur receives the appropriate number of points, they will receive funds. Loan companies use other solutions – their requirements for granting a loan are much lower but the risk is out-weighed by the actual annual rate of charge that is several times higher than in the case of banks. Defaulting debtors may in many cases expect that a representative of the loan company will visit them at home or work and that enforcement proceedings will soon be initiated by a debt collection company.

Microfinancing sector entities combine the advantages of banks and loan companies; those who plan to start a business, as well as small and medium-sized enterprises may easily obtain financing from them and, at the same time, the actual annual rate of charge is relatively low. As regards microfinancing sector entities, a less significant role is played by documented liquidity and securities held. What is more important is the idea for the use of capital.

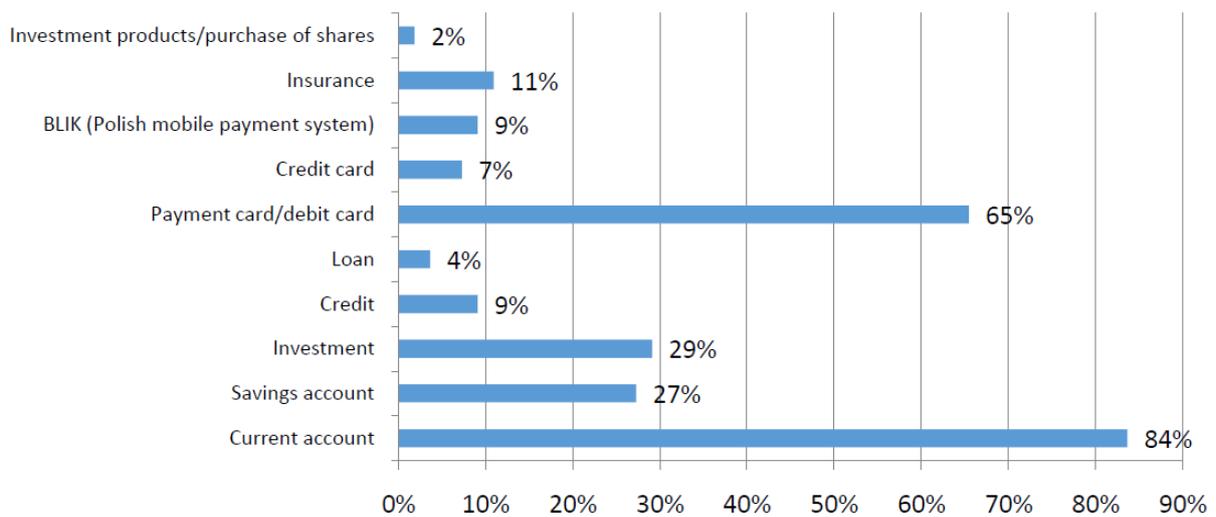
Figure 40: The answers given to the question "Do you use any financial services offered by banks and other financial institutions?"



Source: Own elaboration based on the PAPI study (n=100)

Only 55% of the interviewed potential entrepreneurs have admitted during the PAPI study that they use services offered by financial institutions. This results from the fact that students who have not worked yet believe that they do not need a bank account because they prefer to use cash received from their family. Unemployed persons, in turn, believe that a bank account is unnecessary due to their limited income. Being a customer of financial institutions constitutes a factor encouraging one to improve knowledge about their services. Persons who have not been customers of entities from this sector may make bad decisions resulting from a lack of experience in a situation when they will have to use their services, for instance to take a loan. They are prone to choose a bad variant because they have no knowledge about the offer of rival entities. As a result, it is good to encourage young people to open bank accounts, in particular in view of the fact that services for young people and students are free of charge in many institutions.

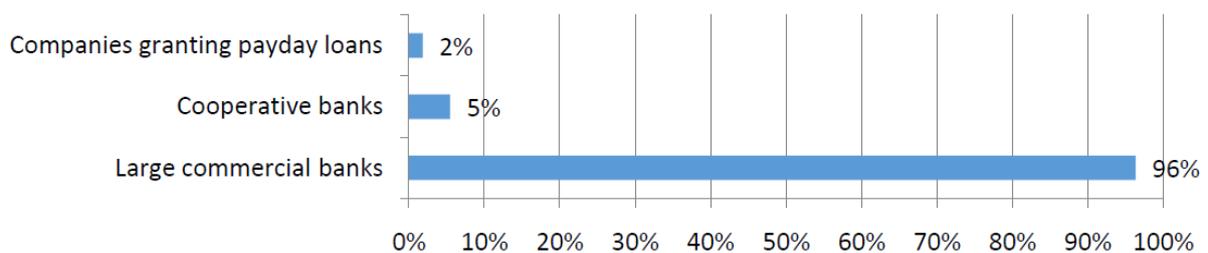
Figure 41: Financial services used by the respondents



Source: Own elaboration based on the PAPI study (n=55)

The PAPI study participants who are customers of financial institutions have been asked what services they use. Most of them are owners of current accounts (84%) and debit cards (65%). Fewer than 30% have a deposit (29%) or a savings account (27%). Other bank products are used by not more than 11% of respondents. It is concerning that not many entrepreneurs have decided to save money. It is much easier to start a business having one's own capital. Persons with their own capital stand a much bigger chance of receiving a credit or a loan in a financial institution.

Figure 42: Financial institutions the services of which use the respondents



Source: Own elaboration based on the PAPI study (n=55)

Almost all respondents in the PAPI study (96%) use the services of commercial banks; only 5% have indicated cooperative banks and 2% have mentioned companies granting payday loans. None of the participants indicated a credit and savings union. It should be considered positive that shadow banking institutions are not very popular. They offer very unfavourable conditions to their clients, who often have difficulties repaying their instalments, a situation that induces them to take other loans and run into a spiral of debt.

1.3 Non-bank enterprises

According to the qualitative research based on IDIs, the major barriers in access to banking services for SMEs include:

- Long formal procedures;
- Highly demanding requirements concerning securities;
- Large monthly variations in incomes making it difficult to prove one's creditworthiness;
- A lack of credit history confirming one's ability to settle liabilities.

Anyone interested may find an alternative offer of SME financing by using the services of the non-bank financial sector. As mentioned previously, non-bank enterprises include loan companies granting so-called payday loans; credit and savings unions, as well as microfinancing sector entities:

Poland's accession to the EU in 2004 has contributed to the increased access of microfinance. As part of the Regional Operational Programmes, projects have been implemented to make access to this form of business financing easier. As part of the Regional Operational Programme for the Świętokrzyskie Voivodeship for 2007–2013, action 1.3 Establishment and expansion of loan and guarantee funds for the Regional Operational Programme for the Świętokrzyskie Voivodeship for 2007–2013, covering 7 projects, was implemented.

As regards banks operating in Poland, their major problem is a high level of non-performing credits - their value in 2015 amounted to PLN 10.8 billion. There were 35.6 thousand reported cases of such credits, including 19.5 thousand credits in zlotys. The rest were foreign currency credits, mainly in Swiss francs, which used to be very popular due to their low interest rate. After the weakening of the new Polish zloty relative to the Swiss franc, however, many borrowers no longer were able to repay their debts on a regular basis. It should be considered positive that microfinancing sector entities in Poland do not have difficulties with the recovery of repaid capital. At the end of 2015, loans with the value of more than PLN 1.7 billion were repaid on time, while only PLN 56 million was seriously threatened (delays in repayment were longer than 90 days). 86.31% of loans were repaid in a timely manner. That there are not many problems in this scope is confirmed by the fact that only 1/3 of lenders from this sector have decided to use the services of external debt collection companies⁵.

Entities supervised by the Financial Supervision Authority (banks as well as credit and savings unions) are covered by the Bank Guarantee Fund. In case they go bankrupt and are not able to settle their obligations towards clients, deposits with the value of up to EUR 100,000 are repaid to clients. Over the recent years in Poland, several credit and savings unions have gone bankrupt due to bad management. This has resulted in lower confidence in these institutions,

which rose to popularity during the last financial crisis, when they emphasised in advertisements that they are not banks. Non-bank institutions are not subject to such supervision and are not covered by guarantee. Consequently, in case of bankruptcy, clients cannot expect that the money invested will be repaid. Accepting contributions in cash in order to expose them to risk is a banking activity and cannot be carried out without the permit of the Financial Supervision Authority. On the website https://www.knf.gov.pl/o_nas/ostrzezenia_publiczne/lista_ostrzezenia.html, one can find notifications about such crimes. It is a valuable source of information for those who think about entrusting their capital to a given entity.

Banks as well as credit and savings unions have to meet precautionary standards concerning equities. They cannot grant an individual borrower a credit higher than 25% of the bank's own funds. This is particularly important in the case of cooperative banks as well as credit and savings unions. When a customer wants to borrow a sum of money exceeding this value, they have to refuse or establish a consortium with another entity. Entities reporting to the Financial Supervision Authority are required to deduct required reserves from current deposits in the value of 3.5% of the amount collected. The lower the required reserves the bigger the possibilities of financial institutions in the scope of money generation. Although in 2003 their level was lowered from 5% to 3.5%, they are still relatively high. It is one of the factors influencing the high stability of the Polish banking system.

2 Financial awareness of people

2.1 Over-indebtedness and precaution measures

In the opinion of the respondents taking part in IDIs, most enterprises from the Świętokrzyskie Voivodeship do not have difficulties with the repayment of their debts. Experts from financial institutions indicate that the most common causes of problems with credit repayment on the part of SME enterprises include:

- A loss of financial liquidity following too expensive investment projects,
- Competition from other enterprises (decreased turnover of a company),
- Fluctuations in the currency market.

The precautions in the scope of over-indebtedness include primarily requirements concerning securities and procedures of creditworthiness verification. Another important factor is also financial education that would prevent running up debts in loan companies, particularly in a situation when there may be difficulties in settling outstanding commitments. It should be

noted that in 2011 the inhabitants of the Świętokrzyskie Voivodeship had the least financial arrears taking into consideration all voivodeships.

2.2 Level of knowledge about finance and education

Over the years 2010–2011, OECD conducted a study concerning financial awareness in 14 countries⁹¹. It was concluded on its basis that, irrespective of a country, people have a limited knowledge about basic issues related to finance. Poland was ranked as low as ninth. The respondents from this country were good at dividing, calculating interest on loans and defining inflation, but performed poorly when it came to a compound interest, noticing links between the risk and rate of return. Moreover, they did not notice the advantages of investment portfolio diversification.

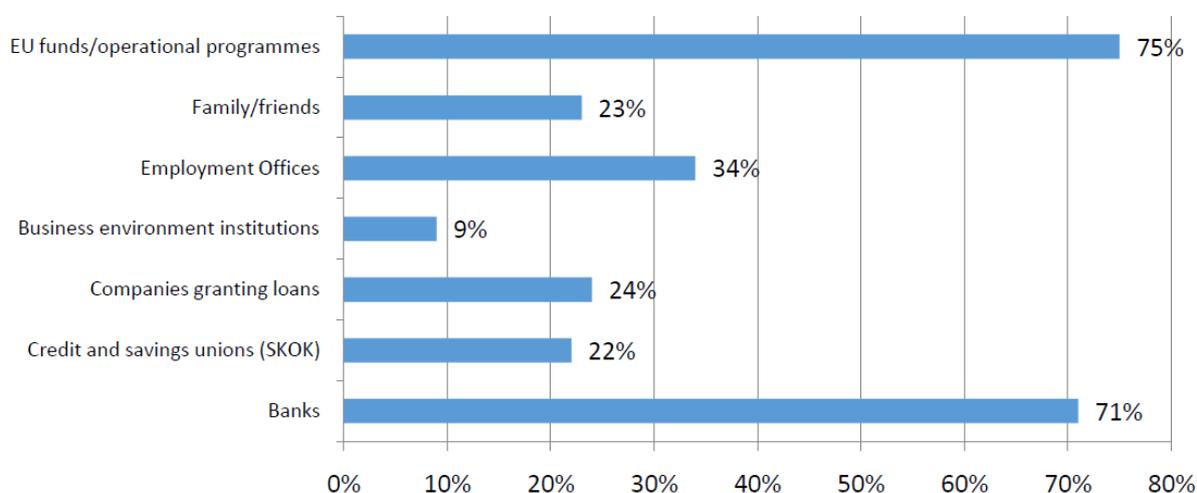
Considering the poor results of Poles and increasing significance of financial services in everyday life, it is necessary to enhance the engagement of state institutions, nongovernmental organisations and enterprises in educational activities concerning financial awareness so that citizens can operate on the financial market without exposing themselves to undue risk⁹². The representatives of financial institutions believe that entrepreneurs have an extensive knowledge about finance. The interviewed persons state that the most reliable source of knowledge in this regard are services of a financial advisor. Experts argue that the most common sources of information used by entrepreneurs are the media, in particular the Internet and friends. In the opinion of the respondents, non-governmental organisations play a significant role in the improvement of awareness about finance. The respondents have mentioned, among other organisations, Fundacja Świat Pieniądza, the activity of which consists mainly in providing children and adolescents with economic education in an accessible and attractive way suited to their age. The representative of business environment institutions, in turn, have indicated that young entrepreneurs are the most active target group for activities oriented on the improvement of knowledge about financial instruments.

Figure 43: Institutions and sources known to the respondents where one may obtain or borrow money for business

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<http://www.oecdilibrary.org/docserver/download/5k9cfs90fr4.pdf?expires=1475757115&id=id&accname=guest&checksum=0EFAB143D3ADF80FD4EB6065D336C284>

⁹² M. Dominik, Świadomość finansowa w Polsce na tle innych krajów, [w] Doktoranci wobec wyzwań gospodarczych, Zeszyty Naukowe Doktorantów Wydziału Ekonomicznego Nr 3, pod redakcją A. Gus-Puszczewicz, Wydawnictwo Uniwersytetu Gdańskiego, Gdańsk 2013 Project co-financed by the European Union from the European Regional Development Fund



Source: Own elaboration based on the PAPI study (n=100)

The external business financing sources most frequently mentioned by the respondents include EU funds (75%) and banks (71%). Other entities have been indicated much more rarely. Only 9% of the interviewed persons have indicated business environment institutions. This suggests that potential entrepreneurs have little knowledge about possible sources of microfinance. It is some business environment institutions that offer persons with limited creditworthiness the possibility to take a loan for starting or expanding a business. One in three interviewed persons have pointed to employment offices, which are an attractive source of business financing, in particular for the long-term unemployed. The term "financing" is associated by the respondents mainly with co-financing for small investment projects, small loans and financing of small enterprises. The associations of the respondents are correct. The subsequent parts of the study, however, show that they do not have knowledge about microfinancing sources. Only 31% of the PAPI study participants have admitted that they have an extensive or large knowledge about finance. It is a very negative situation. A lack of knowledge in this scope may make it more difficult for potential entrepreneurs to acquire financing if they decide to open their own business as well as may result in bad decisions concerning financing.

The most important role in obtaining information about finance in the case of the PAPI study participants is played by schools/universities (64%) and the Internet (54%); the family (34%) and newspapers (33%) are slightly less significant; the radio (13%) and courses (10%) have very little importance. In order to enable the inhabitants of the Świętokrzyskie Voivodeship to obtain knowledge about finance, it is necessary to conduct related courses for pupils and students, as well as to enable them to participate in related training sessions.

It should be considered positive that 84% of the PAPI study participants would like to increase their knowledge about finance. It may be expected that if potential entrepreneurs have the possibility to gain additional education in this regard, they will use it. Potential entrepreneurs taking part in the PAPI study prefer participation in on-site courses about finance (73%). Other answers have been given by about one in four interviewed persons. This suggests that, in order to enable one to obtain information about financial services, it is necessary above all to organise group training sessions. Other forms of education (individual meetings with advisers and on-line courses) should also be implemented. During training sessions, it is recommended to show participants academic publications and handbooks that they may use on their own.

In order to verify the knowledge of potential entrepreneurs about finance, the PAPI study respondents have been asked two questions.

The first concerns the difference between a credit and a loan. About half of the respondents have characterised these two forms of financing in a correct way; a credit is granted by banks for a specific purpose, whereas a loan may be given by any entity or natural person and its purpose is not specified. The question about the difference between banks, credit and savings unions and other institutions lending money has proved much more difficult for the respondents. Many of them have answered that credit and savings unions cannot generate money and trade only in material cash although, due to the legal changes, the activity of such entities practically do not differ from the functioning of banks. The answers given testify to the limited knowledge of the inhabitants of the Świętokrzyskie Voivodeship about the specificity of financial institutions. It is necessary to implement activities that would contribute to its improvement.

3 Efforts to increase the availability of financial services on a regional and national scale

The Country Strategy Papers contain provisions concerning financial exclusion, which is defined as follows: financial exclusion is a process in which people face difficulties in access and/or use of services and financial products provided on the core market that, under appropriate conditions, would be suited to their needs and would enable them to lead a normal social life. The next subchapters present the most important regulations and activities implemented or planned to be implemented on a national and regional level.

3.1 Regional policy, strategies of preventing financial exclusion National Reform Programme

National Reform Programme

- 2015 saw the entry into force of the amendment to the Act on Certain Forms of Support for Innovative Activity, which introduced "a credit on technological innovations". It is an instrument of financial support, the aim of which is to increase the innovativeness and competitiveness of micro, small and medium-sized enterprises by enabling them to implement technological innovations being the results of own R&D work and R&D work acquired by entrepreneurs as part of a project.

- The launch of the second competition as part of sub-measure 2.3.2 "Innovation vouchers for SMEs" as part of the Smart Growth Operational Programme is scheduled for 2016. The aim of the programme to stimulate cooperation between scholars and entrepreneurs by financing services for micro, small and medium-sized enterprises provided by a research unit, contributing to the development of their products (goods or services). As part of the measure, support will be provided for the purchase of a service consisting in: developing a new or considerably improved product, a new or considerably improved production technology or a new design project; or developing a new or considerably improved service.

- There will be launched another round of the financial instrument implemented from 2013 – the Innovation Support Loan Fund dedicated to micro and small companies, enabling the transition from the start-up to the growth phase. The fund will be used to grant loans on preferential interest, the target addressee of which will be enterprises unlisted in the period of up to 55 months after registrations that have not yet distributed profits and have not been established following a merger. The Loan Fund will require the involvement of equity in the form of a signed investment agreement based on which the equity investor – an Angel Investor or venture capital fund – will undertake to inject capital into the enterprise being the borrower in the amount representing a specified proportion relative to the amount of the loan applied for. The loan will amount to – in the scope of cooperation with the VC Fund – from PLN 200 thousand to 2 million and – with Investor Angels – from PLN 200 thousand to 1 million.

Development Strategy for the Świętokrzyskie Voivodeship until 2020

- The activities considered priority as part of the strategic goal Acceleration of economic base development and growth of innovativeness of the voivodeship include support for the development of the SME sector (increasing their competitiveness, growth of export and capital expenditure), development of business environment institution and organisation network, including a network of modern capital support (non-bank guarantee funds, bank export credits and venture capital funds) and support for the development of modern and innovative economy sectors.

- The vision of voivodeship development contain provisions concerning the economic development of the SME sector, which is supposed to be based on the availability of advisory

and consulting services: activation of entrepreneurship will be carried out on a larger scale, in particular in the group of small and medium-sized enterprises operating in the sphere of services. Creating conditions for the development of this sector requires the strengthening of the so-called business environment, so the creation of an injection of capital into regional capital funds and credit guarantee funds, creation of business incubator networks, systems of market information and access to technological and organisational innovations.

3.2 Regional initiatives for better access to microfinancing

Positive initiatives for better access to financing include projects implemented from EU funds as part of the Regional Operation Programme for the Świętokrzyskie Voivodeship, 2007-2013:

- o The extension of the activity of Świętokrzyski Fundusz Poręczeniowy Sp. z o.o. as a form of support for micro, small and medium entrepreneurs in the Świętokrzyskie Voivodeship.
- o Lokalny Fundusz Pożyczkowy (Local Loan Fund) as return financial assistance for MICROENTERPRISES.
- o Establishment and injection of capital into Fundusz Pożyczkowy Województwa Świętokrzyskiego Sp. z o.o. (loan fund).
- o Injection of capital into Fundusz Pożyczkowy Ośrodka Promowania Przedsiębiorczości (Loan Fund of the Centre for Promotion of Entrepreneurship) in Sandomierz.
- o Świętokrzyski Fundusz Pożyczkowy (Świętokrzyski Loan Fund).
- o Loans for MSMEs in the Świętokrzyskie Voivodeship.
- o Credit and loan guarantees for the Świętokrzyskie Voivodeship.

The representatives of the finance and business support sector indicate that the most important result of the actions undertaken so far to improve access to microfinance consists in increased access to EU funds transferred to voivodeship offices and employment offices, as well as executive institutions. In the opinion of experts, the availability of these sources for entrepreneurs has been considerably increased. The respondents participating in IDIs who represent enterprises indicate that they do not see any initiatives in the region that would strive to improve access to micro-financing. It should be noted at the same time that Component A of the Rural Development Programme has not been implemented in the Świętokrzyskie Voivodeship (due to the territorial limitations of its functioning). This component concerned the improvement of the availability of microloans for persons intending to conduct non-agricultural activity in rural areas. In the opinion of the interviewed persons, there are also too few activities oriented on the limitation of financial exclusion.

Selected Good Practices

1 - Microcredit fund for enterprise creation using ESF funds

revolving microcredit fund, not-for-profit, local not nationwide

2 - SODEBUR microcredit facility

Cooperation between not-for-profit entity and the local government, not-for profit microfinance related not-for-profit business development services, revolving local fund, lending does not require legal safeguards, personal contact with customers

5 - Loan fund recapitalization of the centre for business promotion and entrepreneurship in Sandomierz

cooperation between the not-for-profit organization and the controlling authority, not-for-profit micro-lending, revolving fund

6 - Project "Cash on Start"

not-for-profit organization, not-for-profit micro-lending, not-for-profit business development services (coaching)

7 - Building up a broad financial intermediary level in channelling financial instruments

does not exclude not-for-profit microfinancing bodies, selection of financing bodies via open call

10 - Zalaegerszeg credit support programme

local revolving fund, municipal support, not-for-profit fund micro-lending

13 - CEEI Burgos risk assessment methodology

not-for-profit microfinancing bodies, legal safeguards not required, low default ratio, revolving local fund

14 - Combined grant and microcredit scheme structure

not-for-profit microfinancing bodies may apply via open calls, loan combined with aid

15 - FEA's Entrepreneurial Promotional Tools

not-for-profit services, not-for-profit business development, not-for-profit fund, innovative instruments targeted at the younger generation

16 - Rural Financing Programme: Online Credit Application System and Business Development Services to Rural Entrepreneurs

not-for-profit fund, not-for-profit revolving microcredit fund, business development services and coaching free of charge, innovative technologies

