Report 4 – Innovative approaches and products for combating financial exclusion from exclusion to inclusion through microfinance
EXECUTIVE SUMMARY

Goals of the Project

The following report summarizes the results of the work carried out by Working Group 4 within the ‘From Exclusion to inclusion through Microfinance’ project carried out jointly by MFC, EMN and cdfa.

The objective of Working Group 4 was to gather examples of Innovative approaches and products for combating financial exclusion in the form of Case Studies. The brief underlined that the Case Studies should also embrace enterprise and personal finance. The products presented don’t need to be all financial, and could also include business support, insurance, leasing etc., which good practices can be exchanged between MFIs in both parts of Europe.

Main Findings

The causes and consequences of financial exclusion can contribute to social exclusion. Those unable to access finance for enterprise development or personal consumption have greater difficulty in integrating economically through employment and self-employment. Equally they can have difficulty participating in mainstream social activities and those events specific to their cultural reference group. Those who are socially excluded, particularly with respect to networks, decision making and an adequate standard of living are excluded from mainstream financial services which require professional and personal references, credit checks and proof of employment. In times of crisis socially excluded persons may rely on predatory “door step” lenders, further exacerbating their vulnerability and exclusion.1

The group came up with 21 case studies from Western and Eastern Europe, which offer a set of ideas, of starting points for the development of new products, services or approaches.

The case studies represent attempts to overcome the greatest challenges faced by MFIs trying to deliver sustainable credit to micro-entrepreneurs. They are born of long experience by those MFIs, working with people facing different kinds of disadvantage, in a variety of economic, social and environmental contexts.

The case studies focus on at least one of three challenges facing MFIs and the micro entrepreneurs they support. These are:

1. Reducing the costs of delivering micro-finance
2. Increasing the availability of private sector finance
3. Developing the micro-enterprise sector and increasing the sustainability of micro-enterprises.

The first set of microfinance case studies offer ways to address the first issue by using information and communications technology, particularly the internet, and by improving risk analysis.

The second set addresses the need for more private finance by increasing partnerships with banks, and offering loan guarantees.

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1 From Exclusion to Inclusion through Microfinance Working Group 1 – Final Report
The third set focuses on the development of the micro-enterprise sector and increasing sustainability of micro-enterprises by offering not only micro-credit but also other financial and non-financial services such as: leasing, micro-insurance, and/or business support.

Some case studies address more than one issue. Some deal with all three challenges themselves; others demonstrate cooperation between specialist organisations.

Economic and social conditions vary widely between European states, both within, and between, the East and the West. The financial and regulatory frameworks also vary from country to country. There are, consequently, difficulties in trying to apply the solutions used by an MFI in one country to the needs of MFIs in others. For this reason, the authors do not suggest that the programmes described in the case studies which follow can simply be transplanted from one country to another. They do, however, believe that the case studies offer a set of ideas, of starting points for new approaches, which are grounded in the experience of MFIs across Europe, and worthy of closer examination. Each case study includes key learning points and recommendations (the main recommendations are presented in chapter 2).

There is one exception as to the focus of the cases presented. The first case study is slightly different from the others. It does not address micro-finance directly, but shows one way of addressing a fundamental issue for policy-makers wanting to promote microfinance and micro-enterprise as a route to financial as well as social inclusion. This is that microfinance can only be provided to people who have acquired a basic level of financial literacy. At present, the pool of potential micro-entrepreneurs is limited, because a considerable number of people have not attained that basic standard. In recognition of this, policy-makers in some member states are trialing approaches to increasing financial literacy. The first case study comprises a particularly interesting example of this.
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From Exclusion to Inclusion in Microfinance
1. Introduction
The brief of the working group was to identify examples of innovation in microfinance from Eastern Europe which could be applied in Western Europe, and vice versa. All such innovations had to lead, directly or indirectly, to a reduction in social exclusion.

Social exclusion
The group took as its starting point the conclusion of Working Group 1, supported extensively in wider literature, to the effect that one of the key requirements for reducing social exclusion is the financial inclusion of poorer people, which microcredit can facilitate. According to the literature, the causes of social exclusion are similar in Eastern and Western Europe although the magnitude is different. Eastern Europe has experienced dramatic economic change in the past 17 years where in the former communist countries structural reasons for social exclusion prevail. These reasons are first of all unemployment caused by the collapse of state owned industry and farms followed by significant social welfare cuts.
In Western Europe social exclusion is also linked to unemployment. Here, however, unemployment is in part the result of the shift from an industrial based economy to a service oriented and technology dominated economy. A study conducted in 2004 found that the perception of social exclusion is strongly connected with the experience of unemployment and severe financial difficulties, regardless of country. Exclusion from the labour market seems to promote the perception of marginalisation to a greater extent. Especially for EU 15 citizens, access to the labour market, which usually also means access to social protection systems in order to safeguard a certain standard of living, is fundamental for the provision of integration and life chances. Generally, it can be implied that the higher the welfare level of a country, the more people in the severely materially disadvantaged group suffer from the perception that they are outsiders.
Working Group 1 has also stated that in Europe and the South, microcredit for business creation and development is seen as a tool for including poor people in the economy and society, by providing them with an opportunity to take an active part in their economy through entrepreneurship. Entrepreneurship provides the income and bargaining power to facilitate economic well-being, social participation and empowerment.
Thus, the financial inclusion provided through microcredit can achieve a broad range of social inclusion outcomes, including improvements in quality of life, health, leadership and participation.

Financial exclusion
Financial exclusion can be described as the inability of individuals, households or groups to access necessary financial services in an appropriate form. Exclusion can come about as a result of problems with access, prices, marketing, financial literacy or self-exclusion in response to negative experiences or perceptions. In such a context financial exclusion may be either a cause or a consequence of social exclusion, or both.

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3 From Exclusion to Inclusion through Microfinance Working Group 1 – Final Report
4 Centre for Research into Socially Inclusive Services, 2003.
Case studies

Microfinance, then, is recognised worldwide as an effective tool in fighting social exclusion and poverty through the financial inclusion it generates. For this reason, the key criterion for including a case study was, either, that it directly reduced financial and social exclusion through, or in association with, microfinance, or that the mechanism it used could be adapted to do so. The working group also decided that it would only include case-studies which were replicable in at least some other countries, and could show some evidence of success.5

The first case study is slightly different from the others. It does not address micro-finance directly, but shows one way of addressing a fundamental issue for policy-makers wishing to promote microfinance and micro-enterprise as a route to financial as well as social inclusion.

This is that microfinance can only be provided to people who have acquired a basic level of financial literacy. At present, the pool of potential micro-entrepreneurs is limited, because a considerable number of people have not attained that basic standard. In recognition of this, policy-makers in some member states are trialling approaches to increasing financial literacy. The first case study comprises a particularly interesting example of this.

The remaining case studies represent attempts to overcome the greatest challenges faced by MFIs trying to deliver sustainable credit to micro-entrepreneurs. They are born of long experience by those MFIs, working with people facing different kinds of disadvantage, in a variety of economic, social and environmental contexts. For this reason, the authors believe they are essential reading, for both MFIs grappling with those challenges, and policy-makers who want to increase financial inclusion and generate economic development within their countries.

The case studies focus on at least one of three challenges facing MFIs and the micro entrepreneurs they support. These are:

1. Reducing the costs of delivering micro-finance
2. Increasing the availability of private sector finance
3. Developing the micro-enterprise sector and increasing the sustainability of micro-enterprises.

The first set of microfinance case studies offer ways to address the first issue by using information and communications technology, particularly the internet, and by improving risk analysis.

The new information communication technologies associated with social banking can enable customers to feed back preferences, information and complaints to financial institutions, so as to bring about improvements and change. The electronic change which is upon us all, bodes the end of the old boundaries between client and bank, between socially excluded and government, between access and distance. Within this frame, and with the new technology, small needs should be as easily serviced as large: administering small loans

5 One case study from the US is also included, because it is of particular interest.
should no longer be any more expensive than managing large accounts. The time has come for the socially excluded to borrow money on the same conditions as the wealthy: technology will play one part in determining how fast we see the change, social capital will play the other.

The second set addresses the need for more private finance by increasing partnerships with banks, and offering loan guarantees. The third set focuses on the development of the micro-enterprise sector and increasing sustainability of micro-enterprises by offering not only micro-credit but also other financial and non-financial services as: leasing, micro-insurance, and/or business support. Moreover, programs that provide training, advice, mentoring and networking opportunities enhance skills and social empowerment of underprivileged groups, further contributing to inclusion.

Microfinance through its broader range of services such as savings and insurance can further assist poor people to plan for future lump sum needs and to reduce their exposure to income changes or sudden expenses and to participate in social life.

Some case studies address more than one issue. Some deal with all three challenges themselves, such as Ten Senses. Others demonstrate cooperation between specialist organisations (as in the Cooperation Handbook case-study).

Whatever approach is taken, microfinance institutions need to ensure that they have addressed all three issues as they plan their programmes. This is not least because they are mutually reinforcing. For example, increasing sustainability of micro-enterprises, perhaps through high quality post-investment mentoring, reduces the likelihood of default (one of the costs of delivery). In turn, a reduction in default increases the appetite of private individuals and banks to invest.

The authors are aware of the limitations of their report. Not all the case-studies have been in existence long enough for full impact evaluation to have been carried out. Perhaps more importantly, economic and social conditions vary widely between European states, both within, and between, the East and the West. The financial and regulatory frameworks also vary from country to country. There are, consequently, difficulties in trying to apply the solutions used by an MFI in one country to the needs of MFIs in others. For this reason, the authors do not suggest that the programmes described in the case studies which follow can simply be transplanted from one country to another. They do, however, believe that the case studies offer a set of ideas, of starting points for new approaches, which are grounded in the experience of MFIs across Europe, and worthy of closer examination. They have presented a set of key learning points, and recommendations for MFIs and policy-makers, at the end of each case study, as the starting point for that examination.

They would like the microfinance institutions to recognize that they serve a unique market and should be more innovative in developing marketing approaches, products, services and cost-effective delivery mechanisms.

The recommendations have also been collected in the table in which forms section 2.

The authors would also like to underline, that microfinance as well as the other tools presented in the Case Studies need to be coupled with a policy environment which wishes
to radically enlarge the access of the socially excluded to greater income earning and own business opportunities. Although microfinance proved in many cases (as shown in the case studies) to be a very effective in combating financial and social exclusion, it cannot be a stand-alone tool. Greater attention is needed to create regulatory environment that would allow microfinance institutions to extend their financial services and as well as non-credit offerings that will fight all aspects of financial and social exclusion.  

2. Main Recommendations

The following table contains the recommendations from each case study.

<table>
<thead>
<tr>
<th>Case Study</th>
<th>Recommendations</th>
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<tr>
<td><strong>Financial Literacy:</strong></td>
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<tr>
<td><strong>Case Study 1:</strong> Microfinance Centre</td>
<td>• Policy-makers and MFIs interested in increasing entrepreneurship among poorer people may wish to examine the FEWs (financial education workshops) example as a way of using financial literacy to increase the pool of potential start-up entrepreneurs.</td>
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<tr>
<td>Plan Your Future: financial education for low-income people – Poland</td>
<td>• The Policy-makers may wish to consider the value of national financial literacy programmes, because of the reduction the costs of development, design and administration.</td>
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<td>Financial literacy which increases the ability of poorer people to manage their finances and save, creating a pool of potential micro-entrepreneurs</td>
<td>• Both national and local policymakers need to make resources available for long-term support to financial literacy programmes.</td>
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<td>• MFIs need to consider how to minimise costs to their institutions of financial literacy programmes, by using local resources wherever possible.</td>
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<p>| <strong>Reducing the costs of delivering micro-finance:</strong> |                                                                                                                                                                                                                  |
| <strong>Innovative use of internet and distance support</strong> |                                                                                                                                                                                                                  |
| <strong>Case Study 2:</strong> ACCION USA - Online Business Loan Application - USA | • Online loan applications are worth considering as a way of increasing outreach in countries where there is a high level of internet access.                                                                      |
| ACCION USA developed an online loan application form to streamline application processes and | • The costs of establishing and maintaining an online application mechanism are high. For this reason, MFIs considering putting such a mechanism in place should explore the possibility of sharing a single back-office system, supporting different web-page “skins” for each MFI in a country. |
| | • The optional of developing a single Europe-wide infrastructure for online applications should be explored                                                                                                           |
| | • It might be extremely useful to ask ACCION to mentor the first European organisation creating an online application service.                                                                                         |</p>
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<th>Case Study</th>
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| **Increase their outreach nationwide.** | **Case Study 3:**  
Zopa.com – Online Lending and Borrowing Exchange  
- United Kingdom  
*Zopa.com uses the internet for its innovative peer-to-peer lending model. Borrowers and lenders meet without the intervention of banks*  
- MFI is and policy-makers may wish to work together to assess how far an online platform similar to that used to by Zopa may be adapted for business lending within the regulatory constraints of each member country.  
- As well as being an interesting example of the use of the internet, this approach may provide a way to access large numbers of small investments from the private sector which can be placed with micro-entrepreneurs through an MFI intermediary. |
| **Case Study 4:**  
JAK Members Bank - New Support Savings and Loans- Sweden  
*A membership bank allowing investors to lend to businesses, interest-free*  
- MFIs should consider the benefits of establishing institutions in which borrowers and lenders work more closely than in mainstream banks, because this increases access to capital at a low cost, and so reduce the costs of borrowing. They may wish to approach JAK to learn from their experience.  
- Policy-makers may wish consider amending regulatory requirements, if necessary, to allow banks using the JAK model to operate in their countries.  
- Policy-makers may also wish to assess whether, like the Swedish government, they feel it is useful to underwrite loans given on the JAK model, because of their benefits in reducing financial exclusion. |
| **Improved risk analysis:**  
**Case Study 5:**  
Fundusz Mikro loan analysis – Poland  
*New technologies at the services of financially and socially excluded*  
- MFIs in Eastern Europe, a number of which do not use an electronic loan application system, might wish to do so, increasing the quality of decision making and reducing costs.  
- Many MFIs in Europe, especially in the West, face issues with the quality of their portfolio. MFIs operating in Western Europe, which do not all engage in thorough risk analysis, might wish to consider whether the loan template used by Fundusz Micro would increase the quality of that analysis. |
<p>| Increasing the availability of private sector finance: |</p>
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<th>Case Study</th>
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<tr>
<td><strong>Mainstream lending partnerships</strong>&lt;br&gt;<strong>Case Study 6:</strong> Cooperation Handbook - Germany&lt;br&gt;A handbook demonstrating ways for banks and business support organisations to cooperate, reducing costs and increasing lending</td>
<td>• A handbook for cooperation offers opportunities for MFIs and banks to reduce cost through cooperation. MFIs could consider how to replicate it locally.&lt;br&gt;• The handbook, and the cooperation it promotes, can help achieve the macro-economic aims of policy-makers. Because of this, and the fact that it is cheaper to produce a single handbook for each country, policy-makers may wish to fund a national handbook.&lt;br&gt;• Any handbook must be developed with the participation of both banks and BDOs, and be marketed widely.</td>
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<td><strong>Case Study 7:</strong> ProCredit (Bulgaria) Limited&lt;br&gt;Microfinance - Bulgaria&lt;br&gt;A bank which combines microfinance lending with a social mission can be profitable.</td>
<td>• The ProCredit experience shows that microfinance lending can be profitable, and can be developed without direct government support. MFIs could examine the ProCredit methodology in detail to assess how far it can be adapted to meet their own needs.&lt;br&gt;• A detailed feasibility study would be useful to determine how far the ProCredit approach can be applied in the Western Europe.&lt;br&gt;• Policy-makers may wish to examine, in particular, how ProCredit is financed, to determine whether it is possible to provide similar finance in a Western European context. Some sources of capitalisation, such as the International Finance Corporation and the European Bank for Reconstruction and Development, may not be available in the West. EU funding streams available in the West, such as JEREMIE, may however be applicable.</td>
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<td><strong>Guarantees</strong></td>
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| Case Study 8: BG Start | • MFIs should consider offering business support, themselves or through partner organisations, as a condition of a loan. This may increase the likelihood of guarantees being made available, as well as reduce default rates.  
• Business support is expensive, and cannot normally be paid for by the MFI making a loan. Policymakers may find that structural funds are helpful in paying for business support where it is provided as a condition of a guaranteed loan. Such support may help to achieve macro-economic aims.  
• In countries where guarantees are paid for by government, policymakers may want to consider requiring the use of business support services as a condition of any guarantee. |
| **Case Study 9: BoB – Guarantee without a bank** | • Where governments provide loan guarantees, they are likely to achieve greatly increased take up if they allow applicants to obtain a guarantee before they approach a lending bank for a loan.  
• MFIs may wish to support the approach outlined in this case study because it will reduce the likelihood of default on guaranteed loans, and so increase the availability of finance for guarantees in the long-term.  
• Structural funds could be made more widely available to finance guarantees where the approach outlined in this case study is adopted, because they increase the changes of sustainable local economic development. |
| **Developing the micro-enterprise sector and increasing the sustainability of micro-enterprises** | |
| **Leasing** | |
| Case Study 10: JOBS Financial Leasing Project - Bulgaria | • MFIs should consider equipment leasing as part of a portfolio of microfinance delivery mechanisms.  
• MFIs considering leasing should ensure prospective lessees have access to business development support, and that leases are only signed where a high quality business plan has been prepared, demonstrating both the business is likely to succeed, and that income will be sufficient to make rental payments. The prospective entrepreneur might be required to complete business training. Business support must continue during whole of the lease term.  
• MFIs might consider requesting mentoring support from the JOBS programme where they wish to establish leasing scheme combined with business support.  
• Leasing can contribute to financial inclusion and attainment of government policy goals. Policy-makers may therefore consider that capitalising a fund for equipment purchase is a worthwhile investment, where proposed schemes can show expected delinquency rates will be low. Such fund should only be capitalised where business support services can be offered.  
• Where governments provide finance for business support, they may |
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<tr>
<td><strong>Microinsurance</strong></td>
<td>wish to ensure it is made available to MFIs offering equipment leasing</td>
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| **Case Study 12:** Fundusz Mikro – Disaster Loan Fund - Poland  
Peer-to-peer application review and repayment model for disaster recovery lending  
**Microfinance methodologies for efficient and fast relief distribution** | • As the likelihood of flooding in many European countries increases, and as private insurers become less willing to provide flood cover, there will be an increasing need for an alternative mechanism to help affected businesses restart. Policy-makers putting in place disaster recovery plans for areas likely to affected by flooding might consider whether any funds for business recovery should be disbursed through MFIs, using a peer-lending mechanism.  
• The approach may also be useful for other rapid-onset disasters.  
• MFIs may wish to discuss with government whether they should be contracted in advance to put in place a dispersal mechanism, so that they can deliver flood loans when disaster occurs. There is no need for MFIs to focus only on their current borrowers, provided sufficient funds are available to assist others.  
• Since the Fundusz Mikro experience shows that it is possible to operate a flood loan programme with almost no default, it might be possible to capitalise at least part of the fund from private sources. MFIs and policy-makers may wish to discuss this option with banks and ethical investors. The rate of return in the Polish example was less than 5% per year, but this might be satisfactory if, either, there is a government guarantee, or tax advantages are available to lenders. Such an arrangement would, however, depend upon governments covering the cost of administering the loan programme |
| **Case Study 13:** TUK SKOK – Poland  
**Brokerage model for micro-insurance** | • Policy-makers wishing to promote small business development and financial inclusion may wish to consider the benefits of insurance as a way of reducing the likelihood of business failure.  
• Insurance in general, and micro-insurance in particular, is a specialised area, where a high level of technical expertise is essential. MFIs considering putting microinsurance in place should learn in detail from the experience of others. A good place to start would be the Microinsurance Centre (www.MicroInsuranceCentre.org).  
• MFIs should consider partnering with existing insurers to offer products adapted to their clients’ needs, rather than providing insurance themselves.  
• MFIs and policy-makers could consider establishing a single national brokerage company to offer insurance to microfinance clients. Such a company could deliver through a large number of MFIs – reducing duplication and administration costs, and increasing expertise  
• A brokerage company might develop a high level of business quickly by offering insurance to MFIs – where they can demonstrate a track record, have high quality monitoring and loan assessment procedures in place, and where no other insurance already exists (in the UK, for example, it may be provided by the Small Firms Loan Guarantee Fund). |
### Case Study 15: Ten Senses - Fair Trade Market Access - Slovakia

**The Last Mile is the longest: helping producers get their products to the market**

- As Eastern European countries go through transition, and markets become more competitive and globalised, the exclusion of local producers from markets poses a serious threat to the development of their business. This should be an area of concern for MFIs, whose financial returns are often dependent on the success of their client businesses. The Ten Senses approach offers a way to help producer clients to reach their markets.
- Product design consulting is a critical aspect of a market access intervention.
- The synergy between the micro-enterprise development programme and Fair Trade allows a new value proposition to clients from programmes that focus on excluded or vulnerable populations.
- It is possible to run a market access intervention on a sustainable, and even profitable, basis.
- There is a strong demand for market access consulting from MFIs, which, with investment, could become a separate business.

### Case Study 16: Women's World Banking in Spain – Trade House – Spain (case study note)

**New markets for craftswomen**

- MFIs proposing to lend to craft producers may wish to consider offering, directly or through partners, intensive marketing and product design advice, in order to reduce the chance of default.
- Policy-makers wishing to help communities with a high proportion of craft producers (who are usually women) may wish to consider the Trade House model as a way of helping them become more financially and socially included.

### Case Study 17: Bolags Bolaget – Sweden

**Rent your employer**

- MFIs might wish to establish a social enterprise on the Business Business model as a stand-alone business, able to support the people to whom it gives loans. This is very likely to reduce default rates on new-start businesses. It might be sufficient to have a single national company, to whom many MFIs can refer their borrowers.
- Policy-makers could consider commissioning a feasibility study to identify any regulatory barriers to introducing the Business Business model, and making any appropriate amendments.
- **Policy-makers might consider providing grant-finance to pilot the model in their countries, and disseminate the results.**

### Case Study 18: Vernus Cooperative – Slovakia

- Policy-makers and MFIs in Eastern Europe may wish to assess whether the cooperative structure has been overlooked in their countries as a way of bringing borrowers and lenders together.
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| *Not alone against the world, a cooperative approach can turn isolation into synergy for start up entrepreneurs* |  - MFIs in both Eastern and Western Europe may wish to assess whether the cooperative structure can allow them to offer credit under a non-traditional regulatory regime.  
  - MFIs may wish to consider the advantages of ensuring credit is only offered in tandem with, or following, business development support.  
  - MFIs may wish to use the cooperative model as a way to attract small investors to micro-enterprise, both because risks are spread and because a close and balanced relationship may be developed between them and borrowers. |
| **Case Study 19:** Evers and Jung Telecoaching – Germany  
*Telephone mentoring to start-up businesses, reducing default rates* |  - There is an increasing awareness throughout Europe that successful micro-finance depends upon good pre-and post-loan support. The TeleCoaching programme offers a way to provide this at a lower cost than through face to face meetings.  
  - MFIs would benefit from the TeleCoaching programme, provided that it helped reduce default rates. The costs of the programme are considerable, however, and would need to be borne by institutions which value its economic benefits. MFIs and policy-makers may wish to discuss how they can finance the programme between them, so that each obtains the results it needs. |
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| **Case Study 20:** Evers and Jung - Minicontrol – Germany | - MFIs should consider Minicontrol, or a similar tool which they develop themselves, as a way of reducing post-loan mentoring costs, and default. They may find it more cost effective to purchase such a tool, rather than develop it.  
- Minicontrol is likely to be most effective where offered as part of a comprehensive post-loan business support package. This will increase the likelihood that borrowers will use it over a sustained period.  
- Minicontrol can help loan officers by providing an early warning where the business is encountering difficulties, which might mean the loan will not be repaid on time. |
| **Case Study 21:** Microfinance for miners from the depressed former mining areas of Romania. How does the use of combined micro-lending methodologies contribute to the creation of new job opportunities? | - Different approaches and methodologies were used (like the group lending methodology used by CDE or the creation of “Business Associations” promoted by CHF) so that both individual entrepreneurs and existing enterprises could benefit from the program and generate self-employment as well as new job opportunities.  
- Combined measures; micro-credit activities were accompanied by training activities aimed at developing the entrepreneurial spirit, as well as by the creation of workspace centers.  
- Essential element for a positive impact of the project was represented by the creation of partnerships, mainly at local level, whose role was to support the economic development and to promote the actions developed within the project.  
- In Eastern Europe, the use of similar projects in the mono-industrial areas affected by restructuring processes would contribute to a faster development of the respective area.  
- In Western Europe, a positive impact could have the use of the lending methodologies used in the project presented here (Individual lending, group lending and group guarantee lending methodologies). Moreover, the combination of micro-credit activities with other business support services could contribute to the entrepreneurship development, business development and self employment of the targeted social excluded groups in Western European countries. |
3. Financial Literacy

Case Study 1: Microfinance Centre (MFC) Plan Your Future: financial education for low-income people - Poland

Financial education provides poor families with the financial knowledge necessary to create household budgets, initiate savings plans and make strategic investments decisions. It combines economic education contents with the promotion of entrepreneurial attitudes

Financial literacy training which increases the ability of poorer people to manage their finances and save, creating pool of potential micro-entrepreneurs

1. The institution

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www.mfc.org.pl

The Financial Education Project is based on the educational package “Plan Your Future” which addresses the basic financial education needs of low-income people. The package was developed by the Microfinance Centre (MFC) for Central and Eastern Europe (CEE) and the New Independent States (NIS). MFC is the leading regional microfinance resource centre, and a network of 107 microfinance institutions (MFIs) operating in 27 countries of the CEE/NIS, and serving 800,000 low income clients. MFC serves, and facilitates the development of, the microfinance sector, by addressing four critical factors for microfinance in transition economies:

- know-how (MFC Training and Consulting)
- innovation (MFC Research),
- policy change (MFC Policy),
- information exchange (MFC Networking)

MFC began operations in late 1997, as a regional network of twenty-one microfinance institutions (MFIs) and initially provided services only to its members. Currently, through a variety of activities and programmes, MFC targets member and non-member MFIs, national associations, policy-makers, donors, lending institutions and investors. The staff of the MFC consists of 19 professionals based in Poland, Russia, Kazakhstan and Kyrgyzstan.

2. The initiative

The “Plan Your Future” educational package is intended for financial education providers, and contains materials to run financial education workshops (FEWs). The package was designed and tested with target group representatives, and contains:

- learning activity scenarios and guides on how to prepare FEWs and FEW facilitators,
• a financial education compendium, containing financial information and tools, as well as basic information on the theory and practice of adult learning,
• guidelines on how to adapt the basic module to the needs of different client groups, and
• materials for workshops evaluation.

The final output of the workshops is a set of financial plans, developed by the participants for their households.

FEWs help low-income people with practical aspects of domestic financial planning and management, and help them to see the need for it, and for planning and regular saving.

FEWs have generally been received with enthusiasm by those participating in them. The 82% retention rate is all the more remarkable because FEWs were organised for a group of people who generally display a very negative attitude to learning.

3. The target market

The target group was low-income people with limited financial literacy, initially in Poland. Around half of the thirty eight million people in Poland live in poverty or are vulnerable to poverty, because their income is so low that, if there is a series of unexpected expenses, their living standards fall dramatically. Of these, over nine million are low income adults who actively seek to improve their lives. This translates into around five million households. The programme was designed taking into account this target groups’ specific knowledge, attitudes and skills in managing household budgets and using financial services.

4. Client’s views of the programme

• Here are some comments from participants about different aspects of the programme:

  Long-term household financial planning:
  “I realised all the mistakes I was making before the workshops”.

  This change in negative attitudes towards financial planning was undoubtedly the biggest achievement of FEWs.

  Financial planning ability versus implementation ability:
  “I learned how to budget for my needs using whatever money I have”
  “I learned that I can plan my future expenses and give up some things”

  Approach to systematic saving:
  “I was amazed: I realised I could save money on trivial things. I always thought that this was not worth it”.

  Participants completely reversed their view of their ability to save, and the value of doing so.

  A majority of the participants ended the workshops convinced that they were capable of saving, and that small amounts would grow into a useful sum in the future.

  Ability to navigate through a variety of ways to reduce outgoings:
  “I’ve learned to ask about prices when I go shopping – how much is this? I never asked this question before. Now, when I hear the price, I think whether it is too
much. My shop-keeper friend was surprised and she asked me what happened, and I told her I was attending a course on how to save money."

“After the first meeting I got this habit of turning off extra lights at home.”

“Before I put something into the basket in a supermarket, I ask myself – what do I need it for? Do I really need it? A couple of times I have decided not to buy it.”

“I go shopping with a list – it really works! I buy fewer things that I don’t really need.”

Crisis management and rational borrowing:

“A safety cushion allows you to deal with sudden expenses in a stress-free way, giving you the psychological comfort which is so important these days.”

The simple way of managing emergency expenses presented during FEWs (consisting of setting aside small sums every month for an emergency fund, known as a “safety cushion”) met with great interest from the participants. They realised that they were unable to meet their financial goals unless they stabilised their household budgets, by eliminating the leakage of funds caused by emergency expenses.

Financial institutions and their services:

“I’ve realised how little I know about my rights, and about banks”.

It was a revelation for FEWs participants to discover their rights as consumers of financial services. If more information on this was included in the programme, FEWs could be even more effective in contributing to consumer protection, and making the financial market more understandable to poorer people. A visit to a bank, organised as part of FEWs, helps breakdown resistance to using banks, and can keep poorer people decide which banking services might help them.

5. How the approach reduces financial exclusion

A complete assessment of the FEWs contribution to reducing financial exclusion depends conducting an evaluation of the whole programme. The evaluation model has been designed, and will identify the achievement of immediate benefits (outputs) and long term effects (outcomes). The elements of the evaluation process are shown in Figure 1.

An evaluation of the outputs of the pilot FEWs has been completed. These FEWs were undertaken in May and June 2005, with 262 participants from 6 provinces (voivodeships) in Poland, divided into 28 groups. Because the pilot was undertaken quite recently, it is not yet possible to assess long term effects, but the results of the evaluation, in terms of changes in knowledge, skills attitudes, are shown in Table 1.
Figure 1: FEW Programme Evaluation: Flowchart of Elements to be Assessed

**INPUT**
Financial Education Workshops (FEWs)
Content, pedagogy and quality of delivery

**OUTPUT**
Changes in knowledge, skills and attitudes resulting from FEWs

**OUTCOMES**
Better cash management and financial planning practices applied, leading to better living conditions
Table 1. FEW pilot: Short-term changes in key financial awareness indicators

<table>
<thead>
<tr>
<th>Level of achievement</th>
<th>Knowledge Indicators</th>
<th>Skills Indicators</th>
<th>Attitude Indicators</th>
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<tbody>
<tr>
<td><strong>Largely successful</strong></td>
<td>Increased awareness of the complexity of planning family finances</td>
<td>Developing a financial plan</td>
<td>Belief that everybody can and should plan their finances and save money</td>
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<tr>
<td></td>
<td>Insight into what is worth saving for and where a loan is called for</td>
<td>Enriching the variety of the ways to save through rationalisation of expenditure</td>
<td>Belief that small amounts can build up to useful amounts in the long term</td>
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<td></td>
<td>Discovery of a wide range of financial and banking services</td>
<td>Managing emergency expenses in a proactive way</td>
<td>Acquaintance with banks and an interest in what they offer</td>
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<td></td>
<td>Detailed insight into basic savings services</td>
<td></td>
<td>Incentive to learn, take control of, and responsibility for, one's financial affairs.</td>
</tr>
<tr>
<td></td>
<td>Awareness of borrowing traps and consumer rights</td>
<td></td>
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</tr>
<tr>
<td><strong>Successful to some extent and still needs to be reinforced</strong></td>
<td>Insight into more sophisticated savings and credit services</td>
<td>Putting a financial plan into action</td>
<td>[None]</td>
</tr>
<tr>
<td></td>
<td>Better insight into insurance products</td>
<td>How to persuade a spouse and family members to mutually plan family finances</td>
<td></td>
</tr>
<tr>
<td></td>
<td>More specific knowledge of consumer rights</td>
<td>Enriching the variety of the ways to save by seeking new sources of income</td>
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<tr>
<td></td>
<td></td>
<td>Adapting savings services to needs</td>
<td></td>
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<td></td>
<td></td>
<td>Better balancing of saving and borrowing in the management of family finances</td>
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<tr>
<td></td>
<td></td>
<td>Choosing the right credit services</td>
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</table>

6. How the approach reduces social exclusion

As well as the specific outputs assessed above, financial literacy programmes can have a long-term benefit in reducing poverty, especially in domestic crisis situations related to
household life cycle. They can help people build assets over time, and benefit from various economic opportunities. Figure 2 shows how those benefits can be expected from the FEW approach.

**Figure 2: Anticipated effect of FEW programmes on prospective economic wellbeing**

Financial education can help low-income people stabilize their financial situation resulting in improving their living standards.

FEWs give people more control over resources and decision-making, an understanding of how they can help themselves, and an increased interest in participating in civic society. In this way they help build an inclusive, sustainable society. The following argument of the participant reflects also additional social value of the FEWs: "There was something going on, there was a chance to go out, stop thinking dark thoughts and meet other people coping with similar problems".

### 7. Key learning points

1. Basic financial education can achieve considerable changes in the way low-income people perceive their own finances. It can help them stabilise their financial situation, putting them in a position where they can take advantage of opportunities to improve their living standards.
2. Self-employment may be one of those opportunities.
3. FEWs give people more control over resources and decision-making, an understanding of how they can help themselves, and an increased interest in participating in civic society. In this way they help build an inclusive, sustainable society.
4. Basic financial education stimulates interest in financial services.
5. Financial education programmes must be adapted to suit the needs and expectations of different groups of low-income people, and different countries and economic conditions.
6. While the Polish approach was to use a single distribution mode (stand alone workshops), other NGOS need to consider using different delivery
mechanisms which suit local circumstances. These could include social campaigns, and individual guidance, both of which have been used in Poland.

7. There is a case for developing national programmes, because this gives economies of scale.

8. People with status in local communities, such as those who completed FEWs, can be very effective in persuading others to attend workshops.

9. Financial education requires long-term commitment and investment from policy-makers, and support from MFIs. A majority of people assisted will need continuing support and guidance, and there will be new generations for whom financial education will be needed. There is a need for governments, MFIs, other financial institutions and businesses to come together to see how to put long-term, effective programmes in place.

10. The long-term programmes advocated above need to be as self-sufficient as possible, and more innovation is needed to identify ways to achieve this. The Polish programme developed strong local links in the places where it worked, which gave it access to resources such as conference rooms and logistical support, as well as people. The FEWS programme also showed that where there is sufficient understanding of the benefits of financial education, all local costs may be met locally. This enabled it to reach more people at lower cost than if it had no local input, making it more sustainable.

8. Recommendations for MFIs and policy-makers

1. Policy-makers and MFIs interested in increasing entrepreneurship among poorer people may wish to examine the FEWs example as a way of using financial literacy to increase the pool of potential start-up entrepreneurs.

2. Policy-makers may wish to consider the value of national financial literacy programmes, to reduce the costs of development, design and administration. Delivery, however, needs to be adapted to local needs in partnership with local organisations.

3. Both national and local policymakers need to make resources available for long-term support to financial literacy programmes.

4. MFIs undertaking financial literacy programmes need to design them to suit local needs, and to use appropriate delivery modes, one of which may be stand-alone workshops.

5. MFIs need to consider how to minimise costs to their institutions of financial literacy programmes, by using local resources wherever possible.
4. Reducing the costs of delivering micro-finance

4.1 Innovative use of internet and distance support

Case Study 2: ACCION USA – Online Business Loan Application - USA

An online business loan application system.

**ACCIÓN USA developed an online loan application form to streamline application processes and increase their outreach nationwide.**

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ACCIÓN USA is a community based non-profit organisation which provides microloans and other financial services to low- and moderate-income entrepreneurs who are unable to access bank credit. Its parent organisation, ACCIÓN International started its economic development work in 1961, and its first microfinance projects in Brazil in 1977. Its first borrowers were street vendors, carpenters, seamstresses and others who started their own small businesses in order to survive. In the past ten years ACCION partners have dispersed $7.6 billion (€5.9 billion) in loans to 4.1 million borrowers in Latin America, Asia and sub-Saharan Africa.

In 1991, ACCION USA started a pilot programme in Brooklyn, New York, to serve small businesses which lacked access to traditional sources of financing. The programme was successful, and subsequently expanded to six other U.S. cities and to Texas. ACCION USA is the largest network of its kind in the country, and has dispersed over $54 million (€42 million) in small business loans to more than 16,000 entrepreneurs.

ACCIÓN USA launched its online small business loan application in early 2006, making its small business loans available to entrepreneurs throughout the United States. It did this to increase its geographic reach, and also because it saw a substantial market for online loan applications, then exploited mainly by mortgage lenders and student loan providers.

2. The initiative

ACCIÓN built its online loan application form from scratch, because the various existing tools did not provide the detailed information it needed. The aim was to combine a quick and easy process with the ability to collect more information than existing tools allowed, to give them a better understanding of the borrower’s situation. This included personal information, information about the proposed loan, detailed information about current
income and expenses, and the potential for collateral. They also wanted to allow people to write about their business experience.

The application consists of seven pages, which take up to 30 minutes to complete online. Incomplete applications may be saved for a maximum of 30 days. After submission, the application is automatically downloaded to the proprietary loans software, and a credit report is ordered.

A loan officer, based in the organisation’s headquarters in Boston, undertakes a preliminary evaluation of the loan application, and if the loan does not fit the basic lending criteria (for example, if the loan is not for an acceptable business purpose, or the business will not generate enough income to repay it), the application is declined.

If the application passes this first stage, and the applicant lives near one of the local branches of ACCION, located in 8 different federal states, then the application is referred to that branch.

In other cases, the full process is dealt with in the Boston office. The applicant is asked to submit further documents, including a bank statement. After that, a telephone interview is undertaken, and a decision is made on the application. If it is approved, a contract is sent to the borrower, who signs and returns them, a process taking about a week. ACCION has recently introduced online signatures, reducing the delay to a few minutes.

3. The target market

The online small business loan application is aimed at potential and actual entrepreneurs throughout the United States, particularly those who do not have access to financial services, and are not close to an ACCION USA office. Although a high percentage of applications are from start-up businesses, most loans are made to established businesses. Only two start-ups have received a loan.

The target market is not the most excluded group. Most borrowers have some access to credit, though not for business purposes. While there is no loan application fee, interest rates are slightly higher than those of banks, though cheaper than doorstep lenders.

4. A client story

The Gaming Green Pages - publishing entrepreneur

Gary published directories for the gaming and security industries. His Boston-area business (www.gaminggreenpages.com) was thriving, and his directories, which serve as industry-specific phonebooks, were selling well. He wanted to publish new editions, as well as to offer his information services to other industries. His business was poised for further growth, but, like many small business owners, he found it difficult to obtain the additional capital he needed.

His loan application to a traditional bank was turned down because he had only been in business for one year.

Gary looked to the internet for a solution to his problem. He found ACCION USA’s online small business loan application form, and applied for a loan in 30 minutes. He found the
application simple to complete. It took only a few weeks to receive a loan of $15,000 (€11,700), giving his business the capital it needed to expand.

5. How the approach reduces financial exclusion

The online application allows many more people to access the business loans than could previously do so. As a result, applications have been received from each state in the U.S., and loans have been dispersed to people in 26 different states. The number of online applications is rising each month. As at June 2006, 900 online applications have been received. 93 were approved, with a total loan volume of $55,000 (€43,000), and an average loan amount of $6,000 (€4,700).

The application form is also available in Spanish, though less than a 5% of applications have been in Spanish so far.

6. How the approach reduces social exclusion

By implementing an online application loan, ACCION USA made its small business loans available to people throughout the United States. Previously the outreach was limited to people living close to ACCION’s branches. Although ACCION states that most of their borrowers are not totally excluded, they usually have no access to credit for business purposes. Further, ACCION noticed that people applying online have a lower credit scoring than their usual borrowers, which signalises that ACCION reaches more excluded people with their online application.

As migrant minorities are often more affected by social exclusion, ACCION offers its application also in Spanish.

7. Key learning points

1. The use of an internet-based loan application is very effective in increasing outreach. ACCION’s goal is to have half their portfolio provided from internet applications in three or four years. They are aiming for an internet portfolio of about $25 million (€19.5 million), provided to 1500 clients. They believe this is achievable, since growth rates in the numbers of online applications are higher than they expected. ACCION believe, however, that it is very difficult for MFIs to achieve financial sustainability in highly industrialised countries, because of high fixed costs, competition and comparatively low demand.

2. The costs of an online lending programme can be quite high. ACCION spent $50,000 (€43,000) writing the programme, and $30,000 (€23,500) to upgrade their website. Research and testing took nine months all together. They also spent $50,000 (€43,000) on marketing, and in particular contracted a specialist search engine optimiser. They still employ a fulltime web developer.

   ACCION also incur costs from “fishing”. They receive a large number of speculative applications from people who are interested to see whether they would qualify for a loan, but have no intention of taking one out.

3. People applying online have a noticeably lower average credit score than people applying in person. The commonly acceptable credit score used in the U.S. ranges from 400 to 900 points, and for ACCION’s personal applicants averages 590 points. Online applicants average about 540 points. ACCION plan to develop a credit scoring model which will automatically scan submitted applications and
assign a risk level to each. This will reduce the work spent assessing low-rated applications. The risk factors will be assigned using ACCION’s experience.

8. Recommendations for MFIs and policy-makers

1. Online loan applications are worth considering as a way of increasing outreach in countries where there is a high level of internet access, particularly among poorer people.

2. The costs of establishing and maintaining an online application mechanism are high. For this reason, MFIs considering putting such a mechanism in place should explore the possibility of sharing a single back-office system, supporting different web-page “skins” for each MFI in a country.

3. The optional of developing a single Europe-wide infrastructure for online applications should be explored.

4. Online applicants may represent a more risky investment than those who apply in person. Risk assessment systems will have to be developed with this in mind. The ACCION experience is too short to be able to assess the level of default with any accuracy. It may be wise to begin on by allowing an initial online application, but requiring a detailed telephone interview (possibly using a webcam), or a face to face interview, once the applicant has passed the initial screening.

5. It might be extremely useful to ask ACCION to mentor the first European organisation creating an online application service.
Case Study 3: Zopa.com – Online Lending and Borrowing Exchange - United Kingdom

A web-based market allowing investors and borrowers to meet, lowering transaction costs and spreading risk

Zopa.com uses the internet for its innovative peer-to-peer lending model. Borrowers and lenders meet without the intervention of banks

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Zopa is a UK-based private company, started by a small group of people with extensive financial service industry experience, including several members of the company which started the Egg online bank. The aim of its founders was to create a mechanism by which investors and borrowers could meet without the intervention of a bank, reducing the costs paid to an intermediary.

2. The initiative
Zopa is an online platform which allows people with money to invest to meet and lend to creditworthy people looking to borrow. It is a form of peer-to-peer lending. Potential lenders announce on the Zopa web site that they are prepared to lend various amounts of money for varying periods and at different rates of interest. Potential borrowers visit the site to check what rates are on offer. If an offering matches their needs, lenders and borrowers enter into legally binding contracts.

Loans can be for a minimum of £1000 (€1480) and a maximum of 25,000 (€37,000) or more, where the lender has obtained a licence from the regulator, over a term from one to five years. Zopa charges borrowers a one-off fee of 0.5% of their loan, and lenders a 0.5% annual service fee. There is no penalty for early repayment. Zopa offer premium repayment insurance to borrowers.

Zopa does the number of things to reduce risk:

1. The investment of each lender is spread among 50 borrowers, and the amount borrowed by a single borrower comes from 50 different lenders. This reduces the risk of a substantial loss to a single lender as a result of default. It also means that an investor may place as little as £10 (€14.80) with any single borrower.

2. Zopa only allows people who are comparatively good credit risks to use the system. Potential borrowers are credit-scored, based primarily on a credit check, though it may also take into account matters not usually considered by banks, such as people’s attitudes to money, and their Ebay score. Borrowers must be able to
demonstrate a responsible use of credit for the past 6 years, that they have been on
the electoral register for that period, and that they have not increased their
borrowing recently. Potential borrowers who are accepted are allocated to a
market, rated from A* to C, depending on how well they meet the criteria.

3. Software provides lenders with marketing data, and expected levels of bad debt, to
help them decide their terms.

4. Zopa oversees money transfers between the parties. When a loan application is
accepted, Zopa places the loan capital in the borrower's bank account, and monthly
repayments are transferred from borrowers to the various lenders’ Zopa accounts.

5. Zopa had been running for one year at the time that this report was prepared, and
had 80,000 members. Several million pounds had been lent by Zopa lenders to its
borrowers. Member registrations were growing rapidly, were being registered
149% faster during the second quarter of 2006 than during the same period in
2005. The level of money placed and the total number of loans arranged both
increased over 750% over the same period.

6. Zopa uses a standard debt-collection agency to chase bad debts. The current
default rate 0.05%, considerably lower than the estimated rate, which varies from
0.05% to 4.7% over one year, depending on the market. The programme has only
been running for fifteen months, however, and default rates normally increase in
later years of new loan initiatives.

3. The target market

The current principal target market is people wanting to borrow for consumer, rather than
business purposes, and who have a comparatively good credit rating. Zopa has no
government authorisation to make business loans. Nevertheless, some borrowers use the
money for business purposes.

Zopa is extending its activities to help people who have difficulties accessing and finance.
as well as its “C” market, for example, it has an agreement with the Notting Hill Housing
Trust to lend to its members. In that instance it has widened its assessment criteria to
include rent repayment history, and other similar factors which are not reflected in credit
reports. Zopa also intends to create a specialised product to help housing association
members participate in a shared ownership house purchase scheme.

4. Client stories

David – a Zopa lender
David is 64 years old and lives in the West Midlands. He has two grown up children. As a
retired person, David loves keeping active and fit - gardening, golf and walking. He has
always sought security and likes stability. In his professional career he was a civil servant
and he likes to keep control of his money. He received a lump sum from an early
retirement package and has income sources from a number of pension plans - he feels
financially secure.

“Banks have become a lot more competitive over the last ten years”, he says, “resulting in
them becoming a lot less customer-friendly. They have sought to become more efficient
but actually their service levels have declined as they have cut out direct customer contact.
It irritates me that even though they hold onto a substantial amount of money I can't get to speak to someone easily who knows what they are talking about.”

“I heard about Zopa through a friend. It's a great idea. It makes sense - after all there is a huge gap between the rate at which people borrow and the interest can get from a savings account. I can get a better return on my spare cash by cutting out the banks profits - and so can the person borrowing. I thought I would have a dabble, explore it and see if it really works.”

“The website is user friendly and the contact that I have had with Zopa has impressed me. Zopa is friendly and genuinely concerned about their members. It's honest. They keep people informed - and the communications are sensible and mature. With some financial organisations I feel that I am being dealt with as if I were an uninformed adolescent.”

"Lending at Zopa also felt different. It's really easy to use - and I found myself a little more involved - looking regularly to see who I had lent too. I've also been really pleased to see how stringently Zopa vets borrowers. They don't allow my money to be lent to just anyone. I understand they have not had one missed payment from borrowers, and this gives me great confidence."

Rebecca - Borrower
Rebecca is 36 and lives in London with her partner. She is in the process of fulfilling a lifelong aspiration and setting up her own catering business. She is a qualified and experienced chef, but more recently worked as a brand planner in an advertising agency. Since deciding to leave the corporate world, she's been doing freelance strategy work for agencies and brand consultancies to maintain an income level whilst getting her new business off the ground. "There's a big movement of 30-somethings moving out of corporate life. I've got a much richer life now, even though I've got less income", she says.

"I felt there was a bit of a stigma about self-employment and its 'lumpy' income levels. I was really scared about my mortgage and not being able to renew my fixed rate, even though I had money in the bank. I was worried about getting all the proof of projected income that people told me I'd need. I was worried that people wouldn't think I was as 'worthy' as someone who was on PAYE. And yet, I handle my money better than ever now."

"I think Zopa is brilliant. The borrowing process was so easy. I loathe the banks. It makes me very angry how much gets creamed off any product and it rocks me to my soul how much I spend on interest – it seemed so greedy."

5. How the approach reduces financial exclusion
Zopa itself has, at best, a marginal effect on reducing financial exclusion. At present less than 30% of bids, even by high-quality borrowers, are funded. Nevertheless, the effect on financial exclusion may increase as Zopa extends its work with housing associations, and widens the range of creditworthiness accepted in potential borrowers (as with its new “C” market).

Zopa's interest to MFIs lays not its focus on financial exclusion, but rather on the mechanism it uses. It may be possible for MFIs to use this mechanism to access private sector capital, and offer it to potential borrowers.
6. How the approach reduces social exclusion

Although Zopa itself does not focus on social inclusion of its customers, the mechanism it uses could be interesting for MFIs focusing on social inclusion. Especially interesting could be to raise private funds with this methodology.

7. Key learning points

1. Zopa provides an interesting example of how the internet can bring lenders and borrowers together. It appears to offer a way to reduce transaction costs, spread risk, and provide peer-to-peer lending where lenders and borrowers do not have a personal relationship which engenders trust.

2. As a result of the above, the Zopa mechanism may offer a way for MFIs to access small amounts of private sector capital from a large number of individuals for micro financing. This is difficult at present, because transaction costs are high, and the MFI must produce standardised products for its customers. This means that a number of investors must agree the term and interest rate for money they invest. The Zopa schema allows investors with varying expectations of financial risk to place loans at rates which reflect those expectations.

3. Zopa may also provide a way to overcome the difficulty that different investors may require their capital to be returned over the different periods. At present, MFIs in some European countries are exploring different ways of providing a secondary market in investments, so they can repay original investors during the loan term. The Zopa mechanism offers a way to avoid the need to do this, by making each individual loan match the needs of both investor and borrower.

8. Recommendations for MFIs and policy-makers

1. MFIs and policy-makers may wish to work together to assess how far an online platform, similar to that used by Zopa, may be adapted for business lending within the regulatory constraints of each member country.

2. Zopa investors only lend to comparatively good credit risks, and in the consumer market. MFIs wishing to apply the approach to higher risk borrowers, borrowing for business purposes, will need to examine carefully how to manage the consequent increased risk.

3. As well as being an interesting example of the use of the internet, this approach may provide a way to access large numbers of small investments from the private sector, which can be placed with micro-entrepreneurs through an MFI intermediary.
Case Study 4: JAK Members Bank - New Support Savings and Loans - Sweden

A membership bank allowing investors to lend to businesses, interest-free.

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JAK Members Bank was established as a co-operative savings and loan association in 1965, and was granted official bank status by the Swedish government, on the recommendation of the state's Financial Supervisory Authority in December 1997. This means the savings of members are covered by the Swedish banking system's deposit guarantees. This official recognition also confirms that JAK has an approved structure and management, and that it offers a trustworthy alternative to other banks.

JAK’s goal is an interest-free economy, because it believes it is unethical to lend money at interest if there is neither risk nor labour involved. It believes interest has negative effects, including prices rises, concentration of assets in the hand of a few, and exponential growth in the money supply. It offers interest-free loans to show how that there is an alternative.

2. The initiative

JAK Members Bank offers two banking services, based on an interest-free savings and loan system, in which members deposits finance all loans:

- The Original Balanced Savings Loan was designed in 1970, for people who are saving in order to get a loan for themselves or a relative or a friend. In general, all loans have to be balanced by borrower’s earlier savings.

- The New Support Savings and Loan Tool was introduced in 2001. It is designed for small companies and social enterprises who can afford to pay the fee and the instalments but not interest. It has the following features:

  1. Loans have to be balanced by savings, but those savings need not come from the borrower.
  2. The loans are often for social enterprises operating projects with community benefit.
  3. A social enterprise or a company asks for a Support Receiving Account for their project. The bank will assess the character of the applicant before an account is granted.
  4. Once approved, the social enterprise opens a Support Receiving Account at the JAK Bank, and then supporters can open Support Savings Accounts.
  5. The social enterprise can then borrow a fixed amount, covered by the deposits.
6. If the Support Savings Loan Fund becomes smaller than the actual loan, the bank will ask the group of support savers to increase their deposits.

7. If the fund is not replenished, JAK will ask for repayment of the loan within a year.

8. No interest is charged. Loan fees equal 2.5% of the loan.

The JAK Members Bank also emphasizes its community dialogue as an essential activity, because it develops trust between borrower and lender. It has a network of branches which promote dialogue about money and banking systems, rather than offering banking activities. A magazine (Gravel and Gold) supports and publicises member activities.

3. The target market
The target market is small companies, social enterprises and associations in Sweden.

4. How the approach reduces financial exclusion
This project helps to decrease financial exclusion directly because it reduces the cost of borrowing for some small entrepreneurs.

It may also address financial exclusion indirectly. This is because the cost of bank fees and interest is reflected in the price of goods and services. By reducing the costs of borrowing, it reduces the cost of those goods and services, thus making them more affordable for poorer people.

The JAK Members Bank has 32,000 members and its growth is 10% a year. Members have saved a total of €80 million euros and borrowed €70 million (2006). It has thus had a considerable effect on its target group.

5. How the approach reduces social exclusion
The JAK Bank system is based on a special relationship between lender and borrower, who work closely, trust each other and share the same interest in the project they finance, because this project has a social aim. All participants are beneficiaries of this community development project.
In this sense JAK’s approach helps integrate all members into the community and thus combat social exclusion.

6. Key learning points
1. Interest-free banking can be sustainable – the JAK Bank has been running for 40 years.

2. Low-cost borrowing and lending can work where there is a closer relationship between lender and borrower than is the case with mainstream banking, and where both sides share an interest in the success of the project being financed.

7. Recommendations for MFIs and policy-makers
1. MFIs should consider the benefits of establishing institutions in which borrowers and lenders work more closely than in mainstream banks, because this increases access to capital at a low cost, and so reduce the costs of borrowing. They may wish to approach JAK to learn from their experience.
2. Policy-makers may wish consider amending regulatory requirements, if necessary, to allow banks using the JAK model to operate in their countries.

3. Policy-makers may also wish to assess whether, like the Swedish government, they feel it is useful to underwrite loans given on the JAK model, because of their benefits in reducing financial exclusion.
4.2 Improved risk analysis

Case Study 5: FM loan analysis – Poland
Fundusz Mikro Risk analysis of Micro-enterprises - Poland

Internet-based, standardised risk assessment process allowing delegated approval by loan officers in all locations

New technologies at the services of financially and socially excluded

1. The institution
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00-394 Warszawa
Tel : 0048 22 5024500
F: 0048 22 5024502
www.funduszmikro.org

Fundusz Mikro is a microfinance institution, created in 1994 by the Polish-American Enterprise Fund to provide financial services for micro-enterprises in Poland. To date, Fundusz Mikro has distributed 84,967 loans with a total value of €160 million, to owners of micro-enterprises.

2. The initiative
Fundusz Mikro has decentralised its loan-making process by delegating decision-making to individual loan officers, and standardised Excel templates to ensure the decision-making is of high quality. This decentralisation of decision-making has speeded up the loan application process considerably, and lowered operating costs for the institution.

Delegated decision-making can carry a risk of reducing the quality of decision-making, if it is not done carefully. Fundusz Mikro maintain quality by using standardised templates, training loan officers in their use, and in risk evaluation, and requiring every loan officer to justify their the decisions in writing. The justification must include:

- Statistical data on the borrower and his or her enterprise
- The enterprise’s financial data
- Analysis of loan risk factors
- Justification of the loan recommendation
- Cash flow projections for the micro-enterprise

The information is submitted using the excel templates to the Central Loan Administration department, which oversees disbursements and repayments. It can be accessed electronically by the Loan Documentation Supervision team, who can monitor the quality of analysis and appropriateness of loan decision.

The new process has four advantages:

1. Reduced decision-making costs – because less managerial staff time is spent reviewing decisions, and postal costs are not incurred
2. Improved quality of decision-making, particularly where loan officers are based at remote locations. This is partly because loan officers are in the best position to assess the quality of the client and their idea.

3. Increased speed of decision-making. Loans can now be approved within 24 hours, compared with seven to ten days previously, when documents had to be returned to the central office for approval.

4. Improved skills of loan officers.

3. The target market

Fundusz Mikro offers microfinance to financially disadvantaged new, and existing, entrepreneurs throughout Poland. While the immediate target market of the innovation is the MFI itself, the improved decision-making and reduced costs help to make it more sustainable, and so able to offer a better service to its disadvantaged clients.

4. An example

The following pages provide an example of the completed loan approval templates.
Figure 1: Example of Completed Loan Analysis and Justification Form

(RISK ANALYSIS)

1) Why will the borrower want to repay the loan?
   She is a very ambitious person, well known in the community. Group members have evaluated her as a very honest person, in the past she has proven this. She is a very religious person and participates in church activities. She will want to keep her good image and confidence of others.

2) How did you form your opinion?
   I gathered this information during the group meeting. This is the second loan of Ms Kowalska from Fundusz Mikro, and I have been informed that during the first loan she helped other group members in keeping the loan terms.

3) Which features of the borrower prove that he/she will know how to use and repay the loan?
   She has been in this business for 8 years now. She is an ambitious, hard working person. She has a matter of fact approach to problems. Her achievements are a result of her work and persistence.

4) What convinced you to form such an opinion?
   During my visit in her business I evaluated her achievements. This was also confirmed by other group members.

5) Which features of the business indicate, that it will generate sufficient income to repay this and future loans?
   The business has been functioning for eight years. Good locality. Good client base. Appropriate product range and good prices. Ongoing cooperation with shoe wholesalers and with several shoe factories (this also enables her to put in client claims).

6) What convinced you to form such an opinion?
   The shop is located in one of the busiest streets of Lublin. During my visit many coming in clients were recognised by the owner, they chatted with her in a friendly way. The clients in my presence expressed a very good opinion about the shop and its owner. I also evaluated the quality and prices of the shoes by comparing them with other shoe shops in the city. I regard the quality / price ratio as very good.

7) What were the assumptions of cash-flow prognosis?
   20% higher turnover in comparison to last year’s. Profit margin of 35%. Fixed costs are not expected to change during the life of the loan.

8) Why do you consider these assumptions as probable?
   Upon analysing the turnover during the past three years constant growth is evident. This is due to an increasing product range, as well as reduced prices (feasible thanks to trade discounts from the suppliers). Year by year the shop is gaining a better position on the local market, as shown by the growing number of customers. Rent is fixed for the next year.
9) What is the main risk factor connected with:

<table>
<thead>
<tr>
<th>Motivation to repay</th>
<th>Single person, very spiritual. Her life passion is bio-energotherapeutics. She considers herself born for more sophisticated goals.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower’s entrepreneurship</td>
<td>She is not enlarging her business; she only improves what she already has.</td>
</tr>
<tr>
<td>Business</td>
<td>The premises are not her property. The shop requires renovation (investment). A huge risk factor is the competition of big supermarkets</td>
</tr>
<tr>
<td>Cash-flow</td>
<td>High initial cost of the product and due to season (necessity of having all sizes in stock) - risk of not selling a big portion of stock</td>
</tr>
</tbody>
</table>

10) What actions did the borrower undertake to lower the loan risk?

*She analyzed in a very thorough manner her financial options, adapting the loan amount and term to the business’s seasonality. She plans to enhance the standard of the shop to attract more customers. She is very cautious about buying bigger volumes of stock.*

11) What actions did you undertake to lower the risk of the loan?

*The group was informed in detail about the conditions of cooperating with Fundusz Mikro. I analyzed and discussed the cash-flow risk. As a result the loan amount was adjusted to stock. An extra meeting of the group was organised in order to improve group relations.*

12) Why do you consider the undertaken actions sufficient enough to recommend the loan?

*I think that the loan amount and loan period is tailored to the possibilities of the business. The borrower proved her creditworthiness during the first loan.*
# Cash Flow Projections for the Micro-enterprise

<table>
<thead>
<tr>
<th>Results achieved</th>
<th>Jan 00</th>
<th>Mar 00</th>
<th>Apr 00</th>
<th>May 00</th>
<th>Jun 00</th>
<th>Jul 00</th>
<th>Aug 00</th>
<th>Sep 00</th>
<th>Oct 00</th>
<th>Nov 00</th>
<th>Dec 00</th>
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<td>Sales revealed</td>
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<td>Sales estimated by FM</td>
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<td>Assumed results</td>
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<td>by the borrower Sales</td>
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<td>By Fundusz Mikro Sales</td>
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<td>Assumed gross profit (5-6)</td>
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<td>Assumed fixed costs</td>
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<td>Salary per employee</td>
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<td>No of employees</td>
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<td>Cost of employment (8 x9)</td>
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<td>Owner’s salary</td>
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<td>Rents</td>
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<td>Margins on salaries, labour taxes</td>
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<td>Cost of transportation</td>
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<td>Cost of advertising</td>
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<td>Other costs</td>
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<td>Fixed costs per month (10 +...17)</td>
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<tr>
<td>Income before taxes (7-18)</td>
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<td>Tax</td>
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<td>Net cash (19-20)</td>
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</tbody>
</table>
5. How the approach reduces financial exclusion

Good portfolio quality prevents the erosion of loan capital, supports sustainable services and enables the institution to provide financially-excluded people with financial services in the long-term.

6. How the approach reduces social exclusion

As the EU governments may have come to realise, low income communities are severely restricted in their access to financial services. Financial organisations have historically been involved in red lining particular neighbourhoods, communities and areas in respect of the access to financial services enjoyed by the inhabitants of these areas. Financial agencies historically used blanket information on areas rather than precise information on the detailed risks associated with any particular customer. The speed and range of new information processing technologies reduces the need for red lining in the determination of ‘bad risks’. The usage of this approach and technology coupled with a policy environment will radically enlarge the access of the socially excluded to greater income earning and own business opportunities.

7. Key learning points

1. Detailed risk evaluation, in the form of a loan analysis of each client’s character, capacity, capital, collateral, and business environment, in line with the best practices of microfinance worldwide, will help identify and classify risks.

2. Automated control of risk evaluation can lower operating costs, particularly where an MFI covers a large geographic area, when it can reduce travel costs.

3. The decentralization of loan decision making allows loans to be disbursed more quickly.

4. The internet can allow instant review of loan officer decisions, allowing a supervisor to take action before money is disbursed, where necessary.

5. The approach used by Fundusz Mikro can easily be copied by other MFIs.

6. Recording decisions electronically can make statistical analysis easier, allowing decision-making to be improved over time.

7. Requiring loan officers to submit information electronically reduces the need to process it manually twice, once for submission and once for later entry onto an electronic database.
8. Recommendations for MFIs and policy-makers

1. MFIs in Eastern Europe, a number of which do not use an electronic loan application system, might wish to do so, increasing the quality of decision making and reducing costs.

2. Many MFIs in Europe, especially in the West, face issues with the quality of their portfolio. MFIs operating in Western Europe, which not all engage in thorough risk analysis, might wish to consider whether the loan template used by Fundusz Micro would increase the quality of that analysis.
5. Increasing the availability of private sector finance

5.1 Mainstream lending partnerships

Case Study 6: Cooperation Handbook - Germany

A handbook demonstrating ways for banks and business support organisations to cooperate, reducing costs and increasing lending

1. The institution

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The KfW Development Bank was founded in 1948 and is owned by the Federal Republic of Germany (80%) and the Federal States (20%). Based in Frankfurt, it has about 50 offices and representatives worldwide. It has various arms, addressing different needs, including housing, environment, education, and infrastructure and social issues, among others. The KfW SME bank promotes the German SME sector, business start-ups and self-employed professionals at home and abroad, through loans, mezzanine and equity finance, and consulting.

The handbook is the outcome of a microfinance initiative of the KfW, executed by a team of experts including representatives of lending banks, banking associations, local authorities, consulting institutions, business support centres, ministries and the bank.

2. The initiative.

In 2005, KfW SME Bank published a handbook for regional co-operation between banks and business development organisations (BDOs), to facilitate access to financial services of start-ups and entrepreneurs by reducing transaction costs and improving risk management. The publication of the handbook accompanied the introduction of the KfW Micro10 loan programme in the same year.7

The aims of the handbook are:

- to make the financing of small start-ups and investment projects more attractive

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7 The KfW Micro10 was introduced in March 2005. It offers loans between €5,000 and €10,000, using the KfW standard terms and conditions. The application procedure is simple and a flat processing fee of €1,000 EUR per loan is payable to the bank. The KfW pays the flat processing fee of 1,000 EUR to the commercial bank.
• to increase the prospects of success of microenterprises
• to illustrate cooperation approaches which are adequate and applicable
  and the benefits which can be generated from cooperation
• to give advice and information to organisations planning to cooperate.

The key concept behind the handbook is that both lending banks and business support agencies are concerned with the lasting success of the micro-enterprise. This being the case, there is an opportunity to reduce duplication, where each institution undertakes the same activities as it assesses the quality of the entrepreneur and their business. Figure 1 shows where such duplication can occur in the loan granting and advisory process.

**Figure 1: Areas of potential overlap in the loan grant and advisory process**

![Diagram showing areas of potential overlap in the loan grant and advisory process](image)

Note Italicised bullet points represent at least partly overlapping processes in banks and business development organisations.

The handbook illustrates a mechanism for cooperation between lenders and advisers before, during and after the credit decision:

**Phase 1 – before the loan decision**
Microenterprises are referred to the business development organisation (BDO) by the banks. BDO staff provide initial advice, and assess the quality of the business idea. At this stage, it is important to have an agreed set of
criteria for evaluating the proposed business. Projects with good chances of success, and which have complete documentation, are referred (back) to the banks. The business development organisation provides a statement supporting the application for credit. Areas where the client will need continuing business advice and support are identified at this stage.

Phase 2 – loan decision
This phase has the least potential for synergies between the cooperating institutions, at least in Germany, where the law requires that the loan decision has to be made by the bank. If there is a high level of trust between the bank and the business development organisation, though, the former will be able to give due weight to the supporting statement prepared by the latter. In some cases there may also be joint financing, or a sharing of risk.

Phase 3 – after the loan decision
At this point, the key to success is a high level of support (“Active Coaching”), particularly in the case of start-up businesses. Banks can not afford to offer this, and so the BDO does so. As well as helping the business, the involvement of an adviser provides early warning of any problems, and an opportunity to manage any crises. Overall, the risk to the lender is reduced.

As well as outlining the elements of cooperation, the handbook suggests a process for putting it in place, which has nine steps:

Step 1 – Initiation: internal agreement within the bank or BDO about aims, goals and benefits of cooperation
Step 2 – Selection of partners: Who is a potential local partner organisation?
Step 3 – Start of the negotiation process: Presentation of the partner organisation and clarification of ideas and expectations
Step 4 – Definition of aims/goals/targets: definition of the target group, agreements on the size of the cooperation e.g. number of financed micro entrepreneurs. If appropriate, definition of a test phase with a limited number of test cases.
Step 5 – Development of a concept: analysis of demand and competition, formulation of a consent-based cooperation model, specification of processes, methods and instruments, definition of quality criteria and minimum requirements
Step 6 – Financing of the co-operation: overview of all costs and expenses of the cooperation and, if applicable, acquisition of public funds
Step 7 – Record of agreement – this may be anything from a memorandum of understanding to a formal contract
Step 8 – Project start: appointing contact people, agreeing procedures for internal communication and implementation, developing a marketing strategy, arranging regular meetings of the partners
Step 9 – Quality control: reviewing, adjusting and developing the cooperation: assessing progress against targets, identifying reason for any deviation, making necessary changes.
Finally, the handbook provides examples of how existing support and financial measures have been brought together in different parts of Germany, and templates that can be used while developing new partnerships.

3. The target market
While the initiative itself is aimed at banks and BDOs, the ultimate target market is new and growing entrepreneurs.

4. An example
“Auf geht’s!” (“Let’s go!”) – micro loan from the KIZ AG:

“Auf geht’s!” is a project which helps young unemployed people to start their own enterprises in Offenbach. Cooperating partners in the project are the KIZ centre for start-ups (which has offered micro loans since 2002), the local employment agency, the Offenbach savings bank, and Deutsche Bank Foundation. Start-up entrepreneurs receive a comprehensive training and coaching both before, and during the first ten months after, starting the business, and are eligible for a micro loan.

Once the young people have been helped to develop a high quality business plan, they can apply for the “Auf geht’s” loan. They are interviewed by a loan committee which includes the project manager, the coach, representatives of the bank, and a member of the KIZ board. The loan committee approves the loan by approving the depositing of securities out of a fund. Capital for the fund has been made available by the Deutsche Bank Foundation.

Sometimes loans are approved subject to conditions, such as clearing any outstanding debts, or achieving confirmed first orders. Loan approval and
supporting documents are passed to the Offenbach savings bank, which administers the loan.

The bank involved in this partnership benefits from:

- lending only to new businesses with a comparatively high chance of success,
- assistance in the evaluation, support and monitoring of micro enterprises, and
- reduced risk, and transaction costs.

5. How the approach reduces financial exclusion

The aim is to encourage the cooperation of local banks and business support and development institutions in providing loan finance for microenterprise.

The cooperation proposed by the handbook increases the chances that an entrepreneur will receive the loan they need, reducing their level of financial exclusion. Furthermore, the business support will increased the changes of success, with consequent financial benefits. There is also a likelihood that other unemployed people will benefit – in Germany, it is estimated that each new business generates 0.7 new jobs additional to the owner.

6. How the approach reduces social exclusion

Cooperations between institutions offering business development services and banks increase the chances of start-ups to receive appropriate finance. Clients of BDS-providers are educated and they increase skills for business but also daily life. Increased skills and a good education are important to prevent people from becoming socially excluded.

7. Key learning points

1. Impact
   While an impact analysis has not yet been completed, because the initiative is comparatively new, early initial indications are that it has several direct benefits:

   - Reduction in transaction costs, as duplication in loan assessment is eliminated
   - Increase in bank lending
   - Increase in sustainability of businesses. This may be substantial - for example, a cooperation in northern Germany halved the first year failure rate of start-up businesses
   - Reduction in loan default.

   It also has several potential indirect benefits:

   - Reduction in unemployment
   - Increase in economic activity
However, all these benefits have to be seen in the context of the cost of setting up the programme, and running it.

2. Adaptability
In principle, the handbook, and the cooperation it envisages, are easily adaptable to conditions in different countries.

3. Cost-efficiency and sustainability
The initiative is very cost-efficient because it reduces the transaction costs of participants. It is comparatively sustainable because it has low operating costs (once a country-specific handbook as been produced).

8. Recommendations for MFIs and policy-makers
1. A handbook for cooperation offers opportunities for MFIs and banks to reduce cost through cooperation. MFIs could consider how to replicate it locally.

2. The handbook, and the cooperation it promotes, can help achieve the macro-economic aims of policy-makers. Because of this, and to save costs, policy-makers may wish to fund a national handbook.

3. Any handbook must be developed with the participation of both banks and BDOs, and be marketed widely.
Case Study 7: ProCredit (Bulgaria) Limited  Microfinance - Bulgaria

A bank providing microfinance at a profit, with business support

1. The institution

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1233 Sofia, Bulgaria
131, Hristo Botev Blvd.
T: +359 2 921 71 00
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The ProCredit Group is a network of 19 banks operating in transition economies and developing countries in Africa, Latin America and Eastern Europe. Its core business is the provision of formal credit to micro and small enterprises. The business model combines a development policy orientation with a commercial approach.8

The ProCredit Group views itself as a global leader in lending to households and enterprises that have not previously had access to formal credit, or that would not be attractive clients for mainstream banks.9 The Group is committed to both social and commercial objectives. All 19 institutions are locally registered and regulated. Banks are integrated, via the holding company, into a worldwide group in which ideas and experience are exchanged and synergies exploited. All members adhere to a common, set of ethical, environmental and professional standards.

All member banks aim to make a difference by providing banking services to people other banks either do not serve, or serve inadequately. Their main focus is on micro, small and medium-sized enterprises (SMEs), but they also provide consumer retail banking. Banks in the group provide microfinance which earns a commercial return, as part of a comprehensive set of banking services.

The core business of micro and small business finance offers a platform for the provision of numerous other financial services for this target group. Deposit facilities are the most important, and the deposit liabilities of ProCredit Banks are equivalent to about 80% of the loan portfolio.

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8 All banks in the group also benefit from strategic guidance and management from ProCredit Holding AG, a holding company based in Germany, which has shares in all member banks. Its role includes support for refinancing, internal audit, risk management, controls, marketing, human resources, retail banking, as well as the core business of lending.

9 ProCredit banks currently disburse more than 50,000 loans, totaling more than €180 million, every month. By the end of 2005, the number of loans outstanding had grown to more than 560,000 (representing €1.5 billion), a 35% increase compared to the previous year.
2. The initiative
The ProCredit Bank (Bulgaria) started its activities in October 2001, with a capital of BGN 24 million (€12.3 million), and is owned by the International Finance Corporation, the European Bank for Reconstruction and Development, the German Development Bank, IMI Bank and Kommerzbank. It is a development-oriented, full-service bank, with 42 branches.

The bank provides a broad range of financial services, comprising various loan products tailored to meet the needs of micro, small and medium enterprises and private customers, as well as savings and deposit programmes, domestic and international money transfers, documentary business, debit cards and internet banking.

ProCredit Bank (Bulgaria) provides the following business services:

- Agricultural loans, for up to €25,000 over five years. No collateral is required for loans up to €2,500. The loan can be used for working capital or fixed asset investments, and comes with the option of a flexible repayment schedule reflecting the seasonal character of agricultural production. The bank also provides a variety of consumer loans and services. Security may be agricultural equipment. 5% of the loan portfolio is accounted for by the agriculture and food processing sector, whose volume increased by 105% during 2005.

- An easy-access express loan “Sprint” (up to €10,000) accounting for roughly 86% of the total number of business loans disbursed during 2005, with an average loan size of €2,700.

- A “Dynamo” instalment loan ranging from €10,001 to €50,000 with a share of 13% of total outstanding loans, with an average loan size of €8,600.

- Seasonal overdrafts for reliable customers

- Debit cards (with overdraft facilities) to owners and managers of SMEs as part of a standard business loan package

- The “creditmobiles”- two mobile branches which travels from village to village on a fixed timetable, offering micro and agricultural loans.

ProCredit Bank’s staff deal with loan applicants personally and face to face, which is highly labour-intensive. They lend to high quality applicants rather than try to generate high loan volumes. While such personal service is expensive, it does lead to a high quality loan portfolio. Only 1.2% of total loan value is over 30 days outstanding, and loan losses are less than 0.5% per annum.

3. The target market
ProCredit Bank (Bulgaria)’s business customers are all micro, small and medium - sized companies, or individual entrepreneurs, in trade, production or service sectors. Most borrowers have not previously had access to formal credit.
4. A client story
Like many officers leaving the Bulgarian army in the early 1990s, Tashko Dimitrov was unable to find suitable employment, and had no alternative but to start his own business. With two friends who were both experts in meat processing technology, he established a company called Orion Burgas in 1994. When the friends quit only two years later, Mr. Dimitrov was determined to continue without them, and taught himself the specifics of the food industry.

In a crucial period of economic transition in Bulgaria, he continued to develop the range of meat products, and entered a new market in 2003 – the production and sale of convenience foods and frozen vegetables. In early 2004, Mr. Dimitrov borrowed from ProCredit Bank to pay for bringing his new rental premises up to EU food processing requirements. Later he was granted two overdrafts and a credit line. In June 2005, when the manufacturing process was transferred to the newly renovated production plant, a team of EU inspectors gave their seal of approval to the modern production equipment and quality control systems.

ProCredit Bank has also issued bank guarantees enabling the company to participate in tenders. The modern factory has helped to make the company successful and profitable, and the Orion Burgas brand is well known in supermarkets, restaurants and stores throughout Bulgaria.

5. How the approach reduces financial exclusion
The bank provides finance for small, especially very small, businesses. More than 90% of outstanding loans are for amounts of less than € 10,000. The reason for this emphasis on small businesses is the Bank’s view that small enterprises and family-run businesses are the most effective means of ensuring the dignity of the individual while combating marginalisation and poverty in the difficult economic environments in which they operate.

The number of customers of ProCredit Bank (Bulgaria) at the end of 2005 was 80,000, up 51% on the previous year.

6. How the approach reduces social exclusion
The ProCredit Group is committed to both social and commercial objectives. These features distinguish the ProCredit Group from traditional commercial banks which typically focus on corporate business objectives by offering big loans to big clients.

To be a socially responsible lender, a bank must analyse the debt capacity of its borrowers, and this is the heart of ProCredit Bank’s approach to lending. Abstract scoring and screening techniques, which are invariably superficial, do not provide an adequate assessment of prospective borrowers’ ability to take on debt. ProCredit Bank’s procedures deal with loan applicants on a personal, case-by-case basis. This approach is better suited to serve the needs of low
income clients. As a result of this 90% of their outstanding loans are for amounts of less than €10,000, and more than 38% of them are for amounts of less than €1,000.

ProCredit Bank (Bulgaria) provides agricultural loans to a much neglected sector by the other banks, and thus helps employment and social cohesion outside of the main urban areas. Housing loan products are also available to help low-income families renovate their homes and improve energy efficiency.

7. Key learning points

1. A bank which combines a microfinance lending to with a social mission can be profitable, at least in Eastern Europe. ProCredit Bank (Bulgaria)’s return on equity for 2005 was 19%, and the return on equity for the group as a whole, after deduction of profit taxes, was about 15%.10

2. Using a standardised credit assessment and loan management process throughout a group of microfinance providers, allows transaction costs to be reduced to a level which permits profitable lending

3. Such lending can be sustainable over the long term. In 2005 the overall loan portfolio of ProCredit Bank (Bulgaria) increased by 62% to €225 million at year-end, with 38,108 loans outstanding. This figure represented an increase of 9,618 loans (up 34%). Total capital to risk weighted assets stood at 14% in the latter months of the year, exceeding by a safe margin the local regulatory requirement of 12%.

8. Recommendations for MFIs and policy-makers

- The ProCredit experience shows that microfinance lending can be profitable, and can be developed without direct government support. MFIs could examine the ProCredit methodology in detail to assess how far it can be adapted to meet their own needs.

- A detailed feasibility study would be useful to determine how far the ProCredit approach can be applied in the Western Europe.

- Policy-makers may wish to examine, in particular, how ProCredit is financed, to determine whether it is possible to provide similar finance in a Western European context. Some sources of capitalisation, such as the International Finance Corporation and the European Bank for Reconstruction and Development, may not be available in the West. EU funding streams available in the West, such as JEREMIE, may however be applicable.

10 Sister banks operate successfully in Ukraine, Georgia, Moldova, Kosovo, Serbia and Montenegro, Bosnia and Herzegovina, Romania, Macedonia and Russia.
5.2 Guarantees

Case Study 8: BG Start
Guarantees combined with post-loan business coaching

*With its program BG-Start! Hamburg’s guarantee offers post-loan business coaching as an add-on to its bank loan guarantees*

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The Hamburg Guarantee Bank (Bürgschaftsgemeinschaft Hamburg) is jointly owned by local banks, chambers of commerce, business support organisations and insurance companies. Its transactions are underwritten through government guarantees. The bank was set up to support the regional economy, by improving access to finance for entrepreneurs who do not have security acceptable to a mainstream bank.

The bank has a variety of guarantee programmes, and 183 start-up enterprises received a guarantee in 2004.

2. The initiative

BG Start! is an initiative which offers a guarantee combined with post-loan business support. The guarantee is offered to the commercial bank which provides the entrepreneur with a loan. The business support is offered during the first year, and includes:

- An introductory workshop
- An initial meeting, called a status-check, held face to face with the coach, which determines individual coaching needs and goals
- To-do lists, agreed at each intervention
- Where the guarantee is for less than €100,000, two-monthly reports by the entrepreneur to the coach, followed by telephone discussions. Where the guarantee is for over €100,000 (to a maximum of €1 million) reports and discussions are held monthly
- advice from an experienced coach
- business control software.

Coaches working on the programme provide interim reports after six months, and a final report after thirteen months.
The client contributes to the cost of the business support, paying €250 where the guarantee is below €100,000, and €500 for larger loans. As well as helping to fund the programme, this may also make clients more interested in using the service. The balance of the cost is provided through co-financing from the European Social Fund (ESF).

There is a facility under which the borrowers can commence the support programme if they borrow to enlarge their business significantly within three years, and so need a further guarantee.

The programme is constrained by the limited number of high quality business coaches available.

3. The target market
The programme is designed to assist start-up and small scale entrepreneurs who are still in the first year of their business (this includes purchasers of existing businesses). 306 entrepreneurs have been assisted over the two years to the end of June 2006.

4. A client story
An advertising agency relying on a single major customer, faced a crisis when that customer ceased to provide work. The advertising agency applied for, and received, BG Start! support.

The client and its coach met every two months for a year. A number of weaknesses in the business were identified, and solutions put in place, as follows:

- The client presented their skills and work to potential customers without first identifying those customer needs. The coach trained the client in how to identify, and respond to, those needs.
- While the owners of the client company were experts in their field, they lacked management skills. The coach trained them in basic management skills including prioritisation and delegation.
- There was a lack of financial control, and a simple software control tool was introduced. As a result the agency owners could control their finances for the first time.
- The coach provided advice on a number of other issues, including advertising, induction for new employees, contract design and communicating with stakeholders.

As a result of these interventions the enterprise became a sustainable business with a diversified client-base.

5. How the approach reduces financial exclusion
BG Start! is intended to reduce financial exclusion by increasing the sustainability of start-up and young businesses. The techniques it uses appear likely to achieve this goal.
6. How the approach reduces social exclusion
BG-Start’s post-loan business coaching enhances the skills of micro-entrepreneurs. Education and increased skills reduce the risk of becoming socially excluded in future.

7. Key learning points
1. Making business support the condition of a loan guarantee is an effective way of reducing default rates.
2. High quality coaching to start-up and existing entrepreneurs is constrained by a limited supply of good quality coaches.
3. Requiring entrepreneurs to pay part of the cost of the coaching service may increase their perception of its value.

8. Recommendations for MFIs and policy-makers
1. MFIs should consider offering business support, themselves or through partner organisations, as a condition of a loan. This may increase the likelihood of guarantees being made available, as well as reduce default rates.
2. Business support is expensive, and cannot normally be paid for by the MFI making a loan. Policymakers may find that structural funds are helpful in paying for business support, where it is provided as a condition of a guaranteed loan. Such support may help to achieve macro-economic aims.
3. In countries where guarantees are paid for by government, policymakers may want to consider requiring the use of business support services as a condition of any guarantee.
Case Study 9: BoB – Guarantee without a bank

*Entrepreneurs obtain a loan guarantee before they approach a bank for a loan*

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The Land Brandenburg Guarantee Bank is a social enterprise owned by chambers of commerce, business federations, insurance companies and banks in the Brandenburg region. It exists to improve access to finance for entrepreneurs and start-up business people, who do not have collateral acceptable to a bank. This, in turn, supports local economic development.

2. The initiative

Although the amount of the guarantee exceeds the scale of microfinance, the method used here could still be interesting to replicate for microfinance providers.

The BoB (Bürgschaft ohne Bank, “guarantee without a bank”) initiative offers guarantees for loans up to €250,000 for small enterprises. It is different from other guarantees schemes in that the entrepreneur first approaches the guarantee institution, rather than the lending bank. The reason for this is that experience showed that where the entrepreneur first approached a trading bank, they were often rejected without the trading bank assessing either their creditworthiness, or the value of their business idea.

The guarantee bank, in cooperation with local chambers of commerce, evaluates the creditworthiness of the entrepreneur and the business concept. Where the guarantee bank finds both the person and idea of a high standard, they agree an 80% guarantee of the proposed loan. This greatly increases the chance that the bank will grant them a loan.

3. The target market

The target market is start-up and new entrepreneurs who have good business ideas, where those ideas need in-depth analysis and the entrepreneurs do not have the collateral to support a loan, or both.
4. A client story

“I was really unsuccessful with my first business” recalls Stefanie. During her business administration studies she had a small professional writing business, but this failed and she was left with a large debt.

When Stefanie wanted to start her second business, she approached the guarantee bank. She also had start-up business advice and coaching and used a professional accountant. The 40 year old business economist now employs two staff, and has been offering high quality accounting services to her clients for over 9 years. She is also debt-free.

5. How the approach reduces financial exclusion

The initiative increases the chances for potential entrepreneurs to start a business even when they have little or no collateral. It therefore targets the financially disadvantaged. A secondary benefit is that the borrower becomes more financially literate, while creating a business plan which satisfies the guarantee bank.

The programme approved guarantees worth €10 million of loans in 2005. Almost twice as many loans were approved as in the previous year, partly because the maximum guarantee was doubled to €250,000.

6. How the approach reduces social exclusion

The strong financial inclusion aspect helps in return to diminish social exclusion. This would certainly have a much stronger impact, when applied to microentrepreneurs.

7. Key learning points

1. Potential entrepreneurs who need a guarantee for a loan are more likely to receive a guaranteed loan to start a business where they can apply directly to the guarantee organisation, rather than to the lending bank.

2. Guarantee organisations, who wish to take advantage of this way of increasing loan underwriting volumes, will need partners with high quality business support skills.

8. Recommendations for MFIs and policy-makers

1. Where governments provide loan guarantees, they are likely to achieve greatly increased take up if they allow applicants to obtain a guarantee before they approach a lending bank for a loan.

2. MFIs may wish to support the approach outlined in this case study because it will reduce the likelihood of default on guaranteed loans, and so increase the availability of finance for guarantees in the long-term.
3. Structural funds could be made more widely available to finance guarantees where the approach outlined in this case study is adopted, because they increase the chances of sustainable local economic development.
6. Developing the micro-enterprise sector and increasing the sustainability of micro-enterprises.

6.1 Leasing

Case Study 10: JOBS Financial Leasing Project - Bulgaria

*Equipment leasing combined with business support*

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The Job Opportunities through Business Support – “JOBS” Project is a joint initiative of the Bulgarian Ministry of Labour and Social Policy and UNDP. Since its launch in late 2000 it has created a network of 42 business centres (NGOs) and 10 business incubators across Bulgaria. The project operates in rural communities with high unemployment rates, underdeveloped economies and a high percentage of vulnerable groups, including Turkish and Roma minorities. The business centres and incubators provide an integrated package of business support services, including micro financing.

2. The initiative

The JOBS Project Financial Leasing Scheme provides non-bankable business owners with microfinance for purchase of enterprise equipment and machinery, combined with business support. All the client needs is a viable business idea, which will lead to employment for at least one person.

The fund is managed locally by non-government organisations – the business centres and business incubators set up under JOBS Project. Donated funds are used to purchase long-term, used, fixed assets (manufacturing and service sector equipment, vehicles, agricultural machinery, etc.) that are subsequently leased to local entrepreneurs.

The scheme is set up and operated with the close involvement of key community actors, ensuring local ownership, accountability and transparency. It is the local business centre which provides the business support which is a central element of the programme. With its assistance, entrepreneurs choose the equipment and the supplier. They are also given training in basic marketing, finance and business planning, so that they are more likely to succeed in their ventures.
Clients with a viable business idea are assisted through every step of the business development process. Prospective businesspeople must complete a 20-hour training course in marketing, finance and business planning run by the business centre. They are then tested, and all applicants must have at least 80% correct answers (applicants with active businesses are admitted directly to the final test).

The financial consultant at the business centre is responsible for preparing, collecting and reviewing all documents provided by the lease applicant, and for gathering the necessary information in order to establish the client’s creditworthiness. The financial consultant provides the client with advice and assistance throughout the business plan preparation, and makes financial analysis and cash flow forecasts.

A local leasing committee at each business centre reviews all applications for financing. The committee reflects a balance of the local stakeholders involved in private sector development. Its five members represent the municipality, a bank, the Labour Office and the business community (an employers’ association or a local business), and the NGO team leader acts as chairperson. The final approval is by the JOBS Project financial leasing expert. The application process is fast and simple, and the equipment can be delivered within two weeks of the client’s first visit to the business centre.

The JOBS Project leasing scheme solves the main problem faced by the target group lack of collateral. The leased asset serves as the only collateral required. Ownership of the asset is retained until the final lease payment, which provides some protection to the NGO which owns it. Furthermore, no cash is passed to the entrepreneur, lowering the risk of misuse of project funds. Clients may also take advantage of a grace period of up to six months, which may be taken in several instalments during the lease term, to take account of seasonal fluctuations in sales.

The programme is increasing popular, and in the first half of 2006, the portfolio growth rate was 47%. The portfolio breakdown by sector is as follows:

- more than 36% are farmers,
- about 9% are in the textile industry,
- more than 10% are furniture and wood processing companies,
- 25% are service companies, and
- 20% are in another business sector.

3. The target market

Financial leasing is accessible to start-up entrepreneurs, micro and small enterprises, farmers and unemployed people, who would not otherwise have access to credit.
4. A client story

In 2003 Rumiana, 49, lost her factory job, and was assisted by the JOBS business centre in Novi Pazar to set up a successful dry-cleaning business. After receiving basic start-up training, she was helped to write up a business plan, and received €12,500 under the leasing scheme to equip the enterprise. The centre helped Rumiana to find workers and to get special training for dry-cleaners from leading German companies. This rapidly improved quality and enabled her to start offering carpet cleaning and maintenance. Soon the business was growing fast and she decided to build a new facility. The centre again helped with the loan application and in 2006, based on excellent business performance, Rumiana received a bank credit of €100,000 to go ahead with her projects. The business has contracts with local hospitals, childcare centres and hotels. At present it employs six people, and is likely to employ more in the future.

5. How the approach reduces financial exclusion

The programme helps people, who are otherwise unable to access finance to start a business, and to create a good credit history. By doing this it improves their access to mainstream banking services and diminishes financial exclusion. Table 1 provides some evidence that this has happened.

<table>
<thead>
<tr>
<th>Table 1: JOBS Project Financial Leasing Scheme Indicators to 31 July 2006</th>
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</thead>
<tbody>
<tr>
<td>Number of leases</td>
</tr>
<tr>
<td>Value of leases disbursed</td>
</tr>
<tr>
<td>Total cost of the leased equipment</td>
</tr>
<tr>
<td>Jobs created as a result of leasing scheme (created and safeguarded)</td>
</tr>
<tr>
<td>Percentage of women borrowers supported</td>
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<tr>
<td>Percentage of rural borrowers supported</td>
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<tr>
<td>Percentage of start-up companies supported</td>
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</tbody>
</table>

By the end of June 2006, the JOBS Project had assisted 1,098 micro and small companies and unemployed people. Furthermore, leased equipment reduced production costs by 35% on average, leading to higher profits and increased sustainability.

Roma communities in Bulgaria are particularly at risk of financial exclusion. In two of the JOBS Project business centres, the financial leasing scheme was adapted especially to serve start-up entrepreneurs in those communities (with a longer repayment period, an extended grace period, and lower advance payment requirement).

In the JOBS Project case, the project ensures community ownership by using local NGOs to deliver its products. This requires continuous work to build
microfinance skills and capacity within the NGOs. The work includes financial literacy, and so reduces the financial exclusion of those organisations.

6. How the approach reduces social exclusion

The financial leasing mechanism is an efficient tool to fight social exclusion because it gives non-bankable clients a resource to start up and run a business. It is a model of active social policy and enterprise support policy. The JOBS leasing scheme is a tool for including poor people in the economy and society by providing them the opportunity to take an active part in their economy through entrepreneurship and employment.

The JOBS leasing scheme helps unemployed people with entrepreneurial potential to become self-employed and to start a business, and it helps other unemployed people to find jobs in the enterprises that are supported with a lease. For all applicants, access to financial leasing is contingent on the creation of new jobs.

The financial leasing option successfully supports various socially disadvantaged groups such as women, young people and especially ethnic minorities. A specific case is lease disbursement to minority entrepreneurs and companies owned by ethnic Bulgarians hiring Roma workers. By allowing minority entrepreneurs to prove their business skills, this micro financing mechanism enables them to fruitfully participate in the life of the community and to be recognized for their job creation capacity. By providing professional business consultancy, mentoring and networking opportunities the JOBS Business Centres enhance skills and social empowerment of underprivileged groups, further contributing to inclusion.

The JOBS leasing scheme increases the capacity of micro, small enterprise owners and unemployed people through training in basic marketing, finance and business planning and improved business skills. The local business centres provide additional business development service, including:

- Consulting services: business plan development; marketing assistance; firm registration; accounting, etc.,
- Training: business skills; basic marketing and small firm management; etc.,
- Information and information technology services, and
- Incubation programmes and rental space at below market rates for start-up businesses.

The JOBS Project has assisted 21,750 people to get sustainable employment between late 2000 and the end of June 2006. To that date, 30,770 people had profited from specialised training courses organised by the JOBS business centres in finance, accounting, marketing, management, computer skills and foreign languages. The business centres have provided 68,100 business services to local companies.

The JOBS leasing scheme combined with BDS is a tool for social inclusion, as it helps to prevent and redress all the major reasons and areas of exclusion – poverty, low income, lack of market, lack of skills and lack of employment.
7. Key learning points

1. The JOBS Project combines equipment leasing with business support, offering a greater chance for a micro-entrepreneur to create a sustainable business than could either product on its own. Leasing lowers the capital investment required by the entrepreneur, reduces their need to find collateral, and lowers their cost of production. Business support means that he or she is more likely to be able to use the asset to generate a sustainable income. The project is therefore useful as one way of reducing financial exclusion.

2. A consequence of the above point is that there is likely to be a lower rate of default in equipment leases where business support is also offered, which increases the chance of a realistic return on investment. This is important where the initial capital is sourced from an investor rather than a donor. Investment finance will eventually be necessary if the programme is to be sustainable and widely replicable.

3. Business support is needed both before a lease is offered and while it is being repaid.

4. Equipment leasing can form a substantial part of a microfinance programme, at least in countries with limited private sector penetration of the leasing market.

5. Equipment leasing carries a risk of fraud, particularly where vehicles are involved. Detailed analysis of default rates over the medium term would help to identify the level of rental payment needed to cover such default.

6. Leasing is more sustainable where high quality second-hand equipment is rented, both because of the lower capital investment and because there will be a lower fall in the asset value over the rental term.

7. A leasing product can be adapted to different environments. The pattern and size of lease payments can be tailored to the needs of the lessee, and different kinds of equipment may be leased, from basic tools to customised machinery, though the more specialised the equipment, the smaller the potential resale market if the equipment has to be repossessed.

8. The capital outlay on purchasing equipment for leasing can be protected if careful credit assessment is undertaken at the outset, business support is offered, and delinquency control mechanisms are put in place to protect portfolio quality. In the JOBS case, financial sustainability is expected to grow from 104% in 2005 to 125% in 2006.


10. Successful leasing requires intensive promotion, and identification of an initial cohort of clients who eventually succeed.
8. Recommendations for MFIs and policy-makers

1. MFIs should consider equipment leasing as part of a portfolio of microfinance delivery mechanisms.

2. MFIs considering leasing should ensure prospective lessees have access to business development support, and that leases are only signed where a high quality business plan has been prepared, demonstrating both that the business is likely to succeed, and that income will be sufficient to make rental payments. The prospective entrepreneur should be required to complete business training. Business support must continue during the whole of the lease term.

3. MFIs who wish to establish leasing scheme combined with business support could consider requesting mentoring support from the JOBS programme.

4. Leasing can contribute to financial inclusion and attainment of government policy goals. Policy-makers may therefore consider that capitalising a fund for equipment purchase is a worthwhile investment, where proposed schemes can show expected delinquency rates will be low. Such a fund should only be capitalised where business support services can be offered.

5. Where governments provide finance for business support, they may wish to ensure it is made available to MFI clients offering equipment leasing.

Case Study 11: Street UK - Leasing back-office for MFIs - UK (case study note)

MFI offering leasing product on through partner MFIs.

Opening delivery channels for new products by using partnerships.

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Street UK is a well-established UK CDFI with experience in enterprise lending and provision of back-office services to other CDFIs.

2. The initiative

Street UK offers the first UK MFI leasing scheme, which offers enterprise finance for capital equipment at reduced risk for the lender and client. Leasing is available on certain types of second-hand equipment. Lease rental assets sit on the Street UK balance sheet as fixed assets, and are depreciated over the lifetime of the lease.
The significant aspect of the Street UK programme is that it has begun to offer a back-office service to other MFIs in the UK.

3. The target market
- Small scale entrepreneurs unable to access finance from mainstream sources.
- Other CDFIs, who might wish to offer leases to their clients

4. A client story
Lincolnshire Community Business Development Finance Initiative has an arrangement with Street UK under which it can issue loans. This enables their clients to lease equipment (mostly vans) which they could not afford to buy because they have poor credit ratings. The MFI can therefore secure its lending on the capital item, and offer the client a 2% discount as a result. Ten leases totalling £45000 (€66,800) were approved in the first year.

5. How the approach reduces financial exclusion
By helping MFIs widen their product range, so helping entrepreneurs to use equipment which they could not afford to purchase.

6. How the approach reduces social exclusion
Opening up new distribution channels through partnerships helps the socially excluded communities access the service. Leasing services is one of the ways of obtaining necessary equipment for the development of a business, but not very accessible for the micro entrepreneurs. Such initiatives are necessary to support the policy environment which wishes to radically enlarge the access of the socially excluded to greater income earning and own business opportunities.

7. Key learning points
1. There is a market for MFI leasing in Western European countries, despite a well-developed private leasing market.
2. Initiating and operating a leasing scheme is technically and administratively challenging.
3. Because lease rental assets sit on the balance sheet as fixed assets and are depreciated over the life time of the lease, and so there needs to be a match between the depreciation charge and the lease rental income.
4. The decreasing resale market value of the asset over the life of the lease must be taken into account in lease pricing, and a deposit may be needed to compensate for the loss of value when an asset is resold at second, third or fourth hand.
5. Unlike loans, leases may be a subject to VAT.
6. The risk of late or missed payments, and the cost of administration, should be converted to fees charged at the start of the lease.

7. It may be hard to recover assets in the case of default, particularly where they are vehicles, or other easily transportable items.

8. Recommendations for MFIs and policy-makers

1. An MFI proposing to start a leasing scheme would be well advised to seek advice or mentoring from an existing provider, to help overcome the administrative and technical challenges.

2. The specialised back office support needed to operate a leasing scheme differs in a number of ways from microlending. For this reason, MFIs may wish to work together to create a national leasing scheme, delivered through MFIs, so that that expertise may be developed more efficiently.

3. Policy-makers might wish to invite a group of MFIs to establish a national leasing scheme.
6.2 Microinsurance

Case Study 12: Fundusz Mikro – Disaster Loan Fund - Poland
Peer-to-peer application review and repayment model for disaster recovery lending

Microfinance methodologies for efficient and fast relief distribution

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Fundusz Mikro is a microfinance institution created in 1994 by the Polish-American Enterprise Fund to provide financial services for micro-enterprises in Poland. To date, Fundusz Mikro has distributed 84,967 loans to owners of micro-enterprises, with a total value of €160 million.

2. The initiative
Rapid-onset natural disasters - such as floods, hurricanes and earthquakes - have the potential to cause significant damage to the livelihoods of clients of MFIs, and to MFIs themselves. Disaster loan funds (DLFs) are financial reserves, usually established by an initial donor grant, held against the occurrence of a disaster. When disaster strikes, money in a DLF is made available to MFIs so that they can make loans to affected households, to help them cope with the effects of the disaster.

When, in July, 1997, a massive flood hit the south-western parts of Poland, the Polish-American Enterprise Fund decided to assist the victims by providing Fundusz Mikro with a DLF. Initially of US$2 million (€1.56 million), this was later increased to US$3.5 million (€1.56 million). The donor also provided funds to cover the cost of the DLF distribution and management.

Fundusz Mikro developed a peer-lending model to distribute the loans, to ensure they went to entrepreneurs in need, to maximise the likelihood of repayment, and to minimise administration costs. It awarded loans to flood victims who formed groups of five. The group members were responsible for assessing who had suffered the greatest losses and thus for determining how the group loan suffered by each, and so the ratio in which any group loan should be allocated.

The maximum loan was for PLN 10,000 (€2,500), but no loan could be greater than the loss incurred. The groups were responsible for assessing whether the amount applied for was appropriate for each of their members. Fundusz Mikro followed a policy of considering loan applications in order, from
the smallest amount requested to the largest. Consequently, potential borrowers had the incentive to ask only for the minimum amount needed, to increase their chances of receiving a loan.

Each member of a group signed a joint application, confirming that the information presented was true, and guaranteeing the repayment of the loan of one other group member. Fundusz Mikro stated that if they found any information on the application form to be untrue, none of the applicants would be able to receive the flood loan.

The disaster loans were priced at 10% APR (at that time, regular micro loans issued by Fundusz Mikro were priced at 29% APR) and both the loan principal and the interest were collected in a single sum at the end of the two-year term. Ninety-three percent of the loans were repaid on time, and the rest within one year of their due date.

Fundusz Mikro was able to use banks and local government offices without charge where necessary for processing applications, and was able to publish free advertisements. Both of these things helped to keep costs down.

3. The target market

The product was aimed at all entrepreneurs whose businesses had been damaged by the flood, whether or not they were existing Fundusz Mikro clients. This was despite the increased risk of default from new clients. Fundusz Mikro decided that the priority was to assist those most in need. Referrals from existing clients were used to identify affected non-clients.

4. A client story

Ms Kowalska owned a little shoe shop located in the part of a city which was very badly flooded. The flood water damaged all stock, and the premises required refurbishment.

Most of her friends were also badly affected by the flood, so Ms Kowalska could not count on any loans from them. She was also unable to access a loan from the bank (at the time, banks would not serve micro clients). She was at a loss, as she could not continue selling shoes in the damaged premises, and she had no money for refurbishment. She was considering closing down the business and letting her shop assistant go.

One of her neighbours, the owner of a grocery shop, told her that Fundusz Mikro was distributing disaster loans to micro entrepreneurs affected by the flood. To obtain a loan, they were needed to form a group of five micro entrepreneurs.

Ms Kowalska found three more owners of local flood-damaged businesses to join their group. They assessed each others’ business losses. Then they allocated appropriate loan amounts, knowing that the amount of money for the disaster loan was limited, and groups applying for smaller amounts would be assisted first.
They decided that the shoe shop was the worst affected among them, and collectively supported Ms Kowalska’s application for the PLN10000 (€2,500) the maximum amount. Two remaining businesses, a grocery and a florist, each applied for PLN8000 (€2,000), while a bookkeeping service applied for PLN 7000 (€1,760), and a printer for PLN 5000 (€1,260).

While the loans were not enough to cover the full losses, they helped towards the cost of rebuilding the businesses. Ms Kowalska was able to do the basic improvements to her shop in time for the autumn/winter season. Thanks to the loan she could continue to trade.

5. How the approach reduces financial exclusion
The disaster loan fund had a great impact in supporting microenterprises, and preventing many of them from closure or bankruptcy. Of the total of 9000 business affected by the flood, 2000 received DLF loans. Using the microfinance methodology of co-guarantee and peer selection allowed even the tiniest of businesses to access the financing. This was especially important in the post-flood situation, when the businesses lost most of their assets and could not approach traditional financial institutions.

6. How the approach reduces social exclusion
Detailed monitoring of 100 beneficiaries of the flood loan showed that by the end of 1998, only one business went bankrupt. Seventy percent managed to reach a level of business development similar to that before the flood, and 80% were optimistic about the future development of their businesses.

Research conducted by the Polish-American Enterprise Fund suggested that jobs were secured thanks to the loans, though there was no comparison with businesses affected by floods that were not given loans. The trust shown to the micro entrepreneurs expressed in the approach used (co-signers, lack of collateral), helped the flood victims also to gain faith and confidence to rebuild their business and thus combat social exclusion.

7. Key learning points
1. Fast dispersal of DLF loans are needed to ensure businesses survive.
2. Dispersal of loans will be quicker if responsibility for damage assessment and loan disbursement takes place close to the location of the disaster.
3. Extending a peer-to-peer lending model to disaster loans, and giving a single loan to a group of borrowers, greatly speeds up delivery, and may well make it more equitable. The mutual guarantees also increase the chance of full repayment.
4. It is possible to operate a flood loan programme with a nil default rate.
5. The costs of providing relief loans may be lower that that of regular MFI microloans, as was the case in Poland. There are some indications
that it may be lower than the cost of assistance provided by local
governments.

6. Including non-clients can increase outreach in a time of need, and can
potentially result in post-disaster benefits for the MFI, since many non-
clients who received DLF loans from Fundusz Mikro became regular
clients.

8. Recommendations for MFIs and policy-makers

1. As the likelihood of flooding in many European countries increases,
and as private insurers become less willing to provide flood cover, there will be an increasing need for an alternative
mechanism to help affected businesses reopen. Policy-makers putting
in place flood disaster recovery plans might consider whether any
funds for business recovery should be disbursed through MFIs, using a
peer-lending mechanism.

2. The approach may also be useful for other rapid-onset disasters.

3. MFIs may wish to discuss with government whether they should be
contracted in advance to put in place to a dispersal mechanism, so that
they can deliver flood loans when disaster occurs. There is no need for
MFIs to focus only on their current borrowers, provided sufficient funds
are available to assist others.

4. The Fundusz Mikro experience shows that it is possible to operate a
flood loan programme with almost no default. This means it might be
possible to capitalise at least part of the fund from private sources.
MFIs and policy-makers may wish to discuss this option with banks and
ethical investors. The rate of return in the Polish example was
less than 5% per year, but this might be satisfactory if, either, there is a
government guarantee, or tax advantages are available to lenders.
Such an arrangement would, however, depend upon governments
covering the cost of administering the loan programme.
Case Study 13: TUK SKOK – Microinsurance - Poland

Brokerage model for micro-insurance

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TUW SKOK is a company offering insurance to credit unions since the late 1990s, and to their members since 2001. It was started by the national credit union association and individual credit unions in Poland, after some years of offering insurance in close, but unequal, partnership with an external insurance provider.

2. The initiative
TUW SKOK offers insurance to credit unions and their members. It does not focus primarily on microfinance insurance, but its model is of interest because it could be adapted for that purpose. The reason for offering insurance to credit unions themselves was that, by doing so, the company could quickly attain a high sales volume, covering much of its overheads.

TUW SKOK has kept the policies and products it offers simple to understand, and appropriate to the target market. It offers a variety of products, including disability insurance (for which claims monitoring has been an issue), accidental death cover, theft cover, and homeowners or tenant's insurance, and loan protection. All these products help reduce financial exclusion, since poorer people are often unable to access them from mainstream providers. They are particularly important in the context of microenterprise, because micro-entrepreneurs, whose businesses (and any loans provided to them) are at less risk if they have such cover.

TUK SKOK underwrites much of the insurance offered through the brokerage company itself, but not all, and private insurers provide the balance. The latter are accessed through a brokerage company which is owned jointly by TUW SKOK and credit union umbrella organisations. As well the brokerage company, TUW SKOK outsources many other elements of its business, including market research, actuarial work, software development, premiums investment and sales (undertaken by credit unions).

TUK SKOK has been well-capitalised, and so can carry its risk without reinsurance. To cover one significant risk which could affect both TUW SKOK and its partners, a mutual organisation has been created, of which all

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11 Since 2003, loan protection has been offered through a sister life insurance company, which could offer members better coverage, being free from restraints resulting from TUW SKOK being a non-life company
are members. Members undertake to supply additional capital if required, and share the benefit of any surplus in exchange.

TUK SKOK has been very successful in marketing its policies. Three years after offering them to individuals, had 100,000 policy holders.

3. The target market
There are two target groups:

1. Credit unions: offered insurance against: fire; robbery; misconduct or negligence by employees; and insolvency (where depositors are repaid by the insurer).
2. Credit union members: offered over twenty different products.

4. How the approach reduces financial exclusion
Insurance is a vital way of reducing the risks faced by financially excluded people. It is, therefore, one of the essential building blocks of generic financial inclusion, which puts poorer people into a position where they are secure enough to consider self-employment. The programme helps to provide that insurance.

5. How the approach reduces social exclusion
At present, it is considered that a large segment of the Polish population still does not benefit from any kind of insurance protection. Being not protected against the various risks they face on a daily basis, broad segments of the population remain caught in a continuing cycle of vulnerability, which may result in poverty, and social exclusion. Microinsurance is key in combating this.

6. Key learning points
1. Insurance provision is a specialised business, requiring a high level of expertise, particularly to protect against fraud, and the risk of major losses in the early years. Insurers carry a substantial risk during this period, until a critical mass of policy-holders is acquired.
2. By brokering to a range of insurers, MFIs can eliminate the risk of losses from underwriting.
3. MFIs working in partnership with insurance providers can develop products designed for the particular market they address (rather than just offering a lower level of cover for poorer people)
4. An MFI may develop a high level of business quickly by offering insurance to other MFIs, and perhaps to credit unions (e.g. for death or default of members), and only later to their members
5. An insurance-providing MFI will increase its business more rapidly if it provides an incentive for other MFIs to offer its insurance to their clients.
6. MFIs need to ensure that they are providing insurance for the benefit of their clients, rather than merely to protect themselves from loss, and so may wish to offer more than repayment protection insurance. However, entrepreneurs should be offered cover for risks which expose the insurer to little danger of fraudulent claims – such as life assurance, and perhaps public liability cover.

7. Recommendations for MFIs and policy-makers

1. Policy-makers, who wish to promote small business development and financial inclusion, could consider the benefits of insurance as a way of reducing the likelihood of business failure.

2. Insurance in general, and micro-insurance in particular, is a specialised area, where a high level of technical expertise is essential. MFIs considering putting microinsurance in place should learn in detail from the experience of others. A good place to start would be the Microinsurance Centre (www.MicroInsuranceCentre.org).

3. MFIs should consider partnering with existing insurers to offer products adapted to their clients’ needs, rather than providing insurance themselves.

4. MFIs and policy-makers could consider establishing a single national brokerage company to offer insurance to microfinance clients. Such a company could deliver through a large number of MFIs – reducing duplication and administration costs, and increasing expertise.

5. A brokerage company might develop a high level of business quickly by offering insurance to MFIs – where they can demonstrate a track record, have high quality monitoring and loan assessment procedures in place, and where no other insurance already exists (in the UK, for example, it may be provided by the Small Firms Loan Guarantee Fund).
Case Study 14: ADIE – Microinsurance – France (case study note)

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Amelie Benais
E: a.benais@adie.org

The Association de Prefiguration de la Fondation pour la Micro-Assurance, Lyon (France)

The French MFI ADIE is in the process of developing an insurance programme for micro-entrepreneurs in France. It aims to complement microcredit by helping vulnerable and insurance-excluded entrepreneurs gain access to additional personal and business protection.

The microinsurance product is being developed in response to research, which found that MFI clients were facing difficulties in:

- finding insurance
- finding guarantees adapted to their needs
- finding insurance at a reasonable price
- understanding the insurance market
- Understanding the importance of insuring against the main business risks.

The scheme is in development at present.

Three pilots will be launched:

- A pilot project has started in November 2006, in partnership with the Association de Prefiguration de la Fondation pour la Micro-Assurance, of Lyon. A public interest foundation may be established to market it, but in any event it will be operated by a new and separate legal entity, and the products will be sourced from a number of different insurance companies.
- Two other pilots with two insurance groups are also being designed, and will be launched by February 2007.

Insurance will be offered for:

- public liability
- damage to property, equipment and goods.
- temporary work incapacity
- life insurance
- insurance for business goods carried by car
Five hundred micro entrepreneurs will be offered the micro insurance product in the pilot testing phase (2007). ADIE has provided 7500 loans in 2006, and has about 15000 clients; so there is a considerable potential client base.
6.3 Business support

Case Study 15: Ten Senses - Fair Trade Market Access - Slovakia

Fair Trade outlets and business support for female small scale producers.

The Last Mile is the longest: helping producers get their products to the market

1. The institution

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Ten Senses Limited was established to run the Ten Senses market access programme in late 2003, by the Integra Foundation, which manages a micro-enterprise development programme (MED) for women at risk in Slovakia. This MED project began in 1999, and by 2003 had expanded to include almost 600 women in all parts of the country. This programme provides business development support, mentoring and credit for start-up enterprises.

Roughly 35% of the clients of the Integra MED programme are producers. Typical products are: specialty food products, textiles, clothing, carpets, leather goods, wooden goods, candles, baskets and other handicrafts.

By the end of 2002, Integra staff began to realise that the producers among their clients were having increasing difficulty accessing markets for their products. This was mainly due to the changing retail landscape (supermarkets, hypermarkets and “big box” retail developments, and shopping malls,) and the resulting closure of local shops and outdoor markets.

2. The initiative

Typical microcredit focuses on the delivery of financial services, even to entrepreneurs. However, it is clear that in modern economies influenced by globalisation, market access is becoming just as critical as financial access for producers.

In 2003, Integra, in partnership with Accenture Development Partnership and the Shell Foundation, developed a complex strategy to address the restricted market access experienced by its producer clients. The outcome of this was the creation of a new company, Ten Senses Limited, which has since
expanded its retail and wholesale operations in Slovakia and also to Romania, Bulgaria, Serbia, Russia and Kenya.

The services offered to clients are the following:

- Affordable professional consulting in product design, quality and packaging
- Access to the Ten Senses Fair Trade brand
- Product access to Ten Senses retail shops
- Advance payment and secure orders for products
- Access to Ten Senses wholesale channels, which sell products to major regional retailers
- Participation in regular training opportunities that focus on product innovation, advance information on market trends, product life cycle management, etc.

The above illustration shows how the different interventions work together.

Additionally, Ten Senses has become the first certified Central and Eastern Europe member of IFAT, the international fair trade association. This allows client products to be sold under a certified fair trade label, and allows
consumer confidence in the fair trade nature of the production and the supply chain.

3. The target market

The target clients are the participants in the Integra MED programs for women at risk. This includes single mothers, refugees, divorcees, women with low educational achievement, women members of minority groups, women married or partnered with chronically unemployed spouses, victims of domestic violence, etc. While other women also participate in the Integra MED programme, it is specifically designed to be accessible to this group, and has a target of more than 50% of all market access clients from it. The programme may assist individual women, or the companies or associations they own, or are involved with.

The typical client company has one or two full-time employees, with often another two or three working part time.

Ten Senses has classical Fair Trade products (coffee, tea, chocolate, cotton goods, etc.) to complement the locally produced items. Approximately 25% of sales are from these products. Thus, a secondary target group consists of traditional fair trade producers from the developing world.

In 2006 Ten Senses has also created its own fair trade sourcing company in Kenya, with a focus on extending market access services and supply chain to producers in Africa.

4. Client stories

1. Anna from a poor village in Eastern Slovakia, had a hobby of knitting original and colourful stockings for her family. She participated in the Integra MED programme, and began to sell these stockings through Ten Senses. They sold well, but unfortunately her sewing machine and stock of material was lost in a fire. Because she had the security of a secure market for her products, she was able to take a credit to replace the sewing machine, and is back in business.

2. Ruzenka from rural Eastern Slovakia was an expert Easter Egg decorator (a strong tradition in East Europe). With three small children, it was difficult for her to take a normal job. She was encouraged to turn her hobby into a business, sell her products through the Ten Senses shop in Bratislava. This gave her access to urban and tourist markets that she would not be able to develop from where she lived. The eggs are popular with Japanese and American tourists, whom she would never be able to contact without Ten Senses.

3. Maria from South Slovakia was a designer and producer of wire jewellery. The Ten Senses consultant helped her to design unique packaging, which added significant appeal and value to the product,
and enabled her to sell at a higher price. These boxes are cheap and easy to make, yet set her product apart.

5. How the approach reduces financial exclusion

As markets become more sophisticated and globalised, market access becomes a serious problem. Just as this is evident on a global level, with poor markets in the developing world excluded from access to markets in Europe and North America, so it is also a problem within countries. While microcredit itself is becoming more accessible in Slovakia, lack of access to markets means that many loan recipients might fail.

Furthermore, by helping micro-entrepreneurs to gain a steady income from their sales, it may lead to their needing less credit that would otherwise be the case. Indeed, in some cases, the delayed payment terms offered by suppliers may provide all the credit that is needed.

Indirectly, the programme reduces of financial exclusion because the track record and strong sales of a business mean it can access mainstream credit.

6. How the approach reduces social exclusion

Often small producers, particularly women, seek to supplement their income with house-based production of crafts or food. Their hope is that, along with other activities, that this activity will increase income. In some cases, this activity is also seen as an outlet for talents, and as a way of personal fulfilment. However, in the great majority of cases, these people have no understanding of how to turn their skill or interest into economic activity. Thus, a dream that was supposed to become a way to overcome social exclusion can often end up becoming a burden, with equipment and inventory that remains unsold and unproductive. Market access initiatives such as Ten Senses can make the difference between such an initiative resulting in combating or deepening social and financial exclusion.

7. Key learning points

1. Impact: Early indications are a programme such as Ten Sense can have a considerable positive impact on the target group. Table 1 shows the key performance indicators measured to track programme impact in Slovakia.
Table 1: Ten Senses (Slovakia) Ltd. Key Performance Indicators to 30 June 2006

<table>
<thead>
<tr>
<th>KPI 1</th>
<th>Ten Senses turnover</th>
<th>Projected €</th>
<th>Actual €</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>45,347</td>
<td>57,710</td>
</tr>
<tr>
<td>KPI 2</td>
<td>Ten Senses profit (pre-tax/NIBT)</td>
<td>-4,430</td>
<td>7,934</td>
</tr>
<tr>
<td>KPI 3</td>
<td>Number of clients using Market Access</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C1: MA Consulting Clients</td>
<td>185</td>
<td>184</td>
<td></td>
</tr>
<tr>
<td>C2: MA Vendors</td>
<td>45</td>
<td>42</td>
<td></td>
</tr>
<tr>
<td>KPI 4</td>
<td>Growth in Market Access client business income</td>
<td>40%</td>
<td>39%</td>
</tr>
<tr>
<td>% of C1 and C2 clients reporting increased business income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>KPI 5</td>
<td>Growth in client household expenditure</td>
<td>42%</td>
<td>45%</td>
</tr>
<tr>
<td>% of C1 and C2 clients reporting increased household expenditure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>KPI 6</td>
<td>% of Market Access clients from at risk target group</td>
<td>55%</td>
<td>53%</td>
</tr>
<tr>
<td>KPI 7</td>
<td>Market Access jobs created and sustained</td>
<td>225</td>
<td>221</td>
</tr>
</tbody>
</table>

In addition, Ten Senses Slovakia has expanded this programme to the poorer countries of Romania and Bulgaria, where the following outcomes are reported (to 31 March 2006):

- 139 clients have created 232 jobs
- 62% report an increase in income
- 71% report an increase in household expenditure
- 60% are from the at-risk target group

These figures show the benefits of the programme may be greater, the poorer the economy.

2. Adaptability / scalability: Market access remains an issue for entrepreneurs throughout Europe. The combination of business development services with the growing Fair Trade movement appears to be effective in many parts of the continent, particularly in the East. The fact that the Slovakian programme, has spread to five other countries since 2003 indicates that it could have wide application. This view is supported by the fact that Ten Senses staff have helped create market access development strategies with MFIs in Kosova, Armenia and Kenya.
3. Financial Sustainability: Ten Senses is a for-profit company. Its survival depends on earning an income from its work. Income and profit projections from the initial operations in Slovakia are roughly 120% above operational sustainability projections. Integra has invested $300,000 (€234,000) into the development of Ten Senses, and projects full investment recovery by the end of 2007.

4. Cost-efficiency: In terms of number of clients helped per dollar of investment, the project is efficient. With $350,000 (€273,000) invested in 323 clients, and 453 jobs created, the project costs are:
   - $928 (€724)/per client
   - $662 (€517) per job

8. Recommendations for MFIs and policy-makers

1. As Eastern European countries go through transition, and markets become more competitive and globalised, the exclusion of local producers from markets poses a serious threat to the development of their business. This should be an area of concern for MFIs, whose financial returns are often dependent on the success of their client businesses. The Ten Senses approach offers a way to help producer clients to reach their markets.

2. As demand for financial services is reduced in countries with an emerging formal financial sector, market access becomes a way for micro-enterprise development agencies to remain sustainable.

3. MFIs might find default rates are reduced if they offer a market access programme, incorporating design advice. It is possible to do this profitably.

4. MFIs working with excluded or vulnerable populations, such as immigrants, might find a combined micro-enterprise development programme and Fair Trade provides a valuable new service to their client group.

5. There is a strong demand for market access consulting from MFIs, which, with investment, could become a separate business.

6. The Ten Senses intervention is only useful for producers. Because many clients of MFIs work in retail and services, a Ten Senses style programme might be valuable mainly as a component of a more comprehensive enterprise development programme.
Case Study 16: Women’s World Banking in Spain – Trade House – Spain (case study note)

Shops, and design and business support, for craftswomen, particularly immigrants.

New markets for craftswomen

1. The institution

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Women’s World Banking in Spain (“WWB”, Fundación Laboral WWB en España), is a non-profit Foundation, created in 1988, to help integrate and promote women in their working life. WWB increases awareness of the problems facing women entrepreneurs, by acting in international conferences. Its core activity, however, is working directly with women, advising them when they start businesses, providing them with business training, and supporting their trade activities. Among other things, WWB offers credit. Since its inception 8055 small loans have been given to micro-entrepreneurs

2. The initiative

The Trade House initiative provides free retail outlets, where craftswomen can promote their products, receive business training and create business networks. The shops sell wood, ceramics, jewellery, food and other products. Every two months, a group of craftswomen (there are between 20 and 25 women in each group), comes to a Trade House from different parts of rural Spain.

Before their arrival, the women receive a commercial training book, with information about fixing prices and products labels, so that they can review their practices. When they arrive in the Trade House, they participate in six hours of training, covering such topics as prices, marketing (presentation, design, colour), and consultants review their product design and marketing with them. They are then able to test-market their products in the shop, at no cost.

3. The target market

This project assists poorer and immigrant women in rural, and underprivileged urban, areas.
4. A client story
Alia is a craftswoman who paints silk, making handkerchiefs, fans, lamps, postcards, etc. She was one of the first clients of the Trade House. When she arrived, a professional designer helped her create original packaging, including boxes, labels and bags. Trade House then invited representatives from various famous shops to come and see her products, and helped her negotiate contracts with them.

The Trade House experience helped Alia, who had just created her brand name, but was almost unknown, to establish an image and create a new market, all within two months.

5. How the approach reduces financial exclusion
Many craftswomen in Spain are located in rural areas, and craft production can help economic revival in these regions. The women are, however, far from their potential markets, and often lack any business training. The project overcomes these barriers.
During the life of the project in Spain over 15000 craftswomen received their training and could promote their products in the outlets.
Recently WWB, with the financial assistance of the Spanish Agency for International Cooperation is opening a new outlet for craftswomen in Morocco.

6. How the approach reduces social exclusion
The Trade House initiative combats social exclusion in different ways. Its main objective is to allow craftswomen to improve their financial situation, by helping them to earn more money with their business. Many craftswomen in Spain are located in rural areas, and craft production can help economic revival in these regions. These women are, however, far from their potential markets.
The project overcomes this barrier because the Trade House is a shop where they can sell their products at no-cost and can find new markets and clients.
The craftswomen are also excluded from accessing the market because in most cases they often lack any business training, and this they receive in the outlet.
The training is different for each woman, depending on her situation and her products. The tailored approach helps them to develop their businesses and access markets. During the life of the project in Spain over 1.500 craftswomen received training and could promote their products in the outlets.

7. Key learning points
1. High quality business support for craft producers should include individual design advice. Intensive, hands-on support from professionals, particularly designers, helps craft producers in less developed areas to give their products the image they need, to sell in a competitive market.
2. The Trade House model did not charge its users, and it was expensive to run. There may be scope to recover some or most costs by charging fees to users.
8. Recommendations for MFIs and policy-makers

1. MFIs proposing to lend to craft producers may wish to offer intensive marketing and product design advice consider offering, directly or through partners, in order to reduce the chance of default.

2. Policy-makers wishing to help communities with a high proportion of craft producers (who are usually women) may wish to consider the Trade House model as a way of helping them become more financially and socially included.
Case Study 17: Bolags Bolaget – Sweden
Social enterprise employing new-start entrepreneurs, and supplying back-office and associated support

Rent your employer

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Bolags Bolaget was started in May 1999 by a non-profit association.

2. Innovative service: Bolags Bolaget
Bolags Bolaget, which means “Business Business”, was created as a response to the problem that there was no half-way house between employment and self-employment in Sweden. Anyone wishing to sell a product was required to register, to obtain permission to issue invoices from the tax authorities. They also had to take full control of all aspects of operating a business – including accounting, for example - at time when they were still trying to develop and market it, and when cash-flow was very tight.

Business Business, which is a social enterprise company, overcomes this problem by offering an administrative platform for people who want to run a business, without starting a formal company of their own. Instead they become employees of Business Business. They are still, practice, operating a separate business within that company. User-employees effectively rent their employer, and can cancel the arrangement at any time.

When an entrepreneur wants to start business, he or she signs a “Memorandum of Understanding” with Business Business, which lays out the roles of each. The entrepreneur takes full responsibility for delivering the product or service, and for working towards making a profit, while Business Business handles the administration. Developing the relationship may be very simple, requiring only a single phone call, followed by signing the memorandum.

Business Business takes control of the flow of money, including invoicing, receiving payments, and paying wages, suppliers and VAT. It undertakes to do this accurately, and in accordance with the law. It opens a separate cost centre in its accounts to deal with all the book-keeping for the user, so transactions can be monitored at all times.

Business Business does not offer credit, so payments can only be when there is sufficient money in a user’s account to cover them. Business Business
charges 15% of the sales, and an administration fee, for doing this. This is sufficient to cover its running costs.

3. **The target market**
The target market is people wanting to start businesses, usually with no previous business experience, including employees.

4. **How the approach reduces financial exclusion**
The approach also offers a low-risk way for people to test their business idea. They do not need to invest in computers etc. to deal with administration, and may not need to resign from their current job. This reduces the financial risk they face. It is also cheaper for the entrepreneur than employing independent professionals to undertake accounting and payroll functions.

5. **How the approach reduces social exclusion**
People facing financial exclusion, who wish to become self-employed in order to overcome this, face many problems apart from accessing micro-finance. They often find it hard to learn business skills, such as accounting, invoicing, credit control, etc., at the same time as they are trying to perfect their technical skills in producing and selling a product or service. Business Business helps them overcome that problem. This reduces the financial risk they face and as a result the social exclusion which could be the consequence of business failure.

6. **Key learning points.**
   1. A social enterprise intermediary can reduce the financial risk facing people starting a new business, and may increase their chances of success by handing administrative and financial matters on their behalf.
   2. Such an approach can grow rapidly, and be sustainable. During its first year, Bolags Bolaget grew to 215 employees spread all over Sweden, and has now been trading for seven years.
   3. The Business Business model appears to be comparatively easy to copy in other European countries, in both the East and the West, subject to the next point.
   4. Each country’s rules regarding the separation of legal entities varies. In Sweden, it is possible for a company to employ people who are effectively running separate companies as their employment. This may not always be the case.

7. **Recommendations for MFIs and policy-makers**
   1. MFIs might wish to establish a social enterprise on the Business Business model as a stand-alone business, able to support the people
to whom it gives loans. This is very likely to reduce default rates on start-up businesses. It might be sufficient to have a single national social enterprise to which many MFIs can refer their borrowers.

2. Policy-makers could consider commissioning a feasibility study to identify any regulatory barriers to introducing the Business Business model, and making any appropriate amendments.

3. Policy-makers might consider providing grant finance to pilot the model in their countries, and disseminate the results
Case Study 18: Vernus Cooperative - Slovakia

A cooperative structure bringing together angel investors and women entrepreneurs from at-risk groups, attracting private finance, spreading risk and avoiding restrictions on credit provision.

Not alone against the world, a cooperative approach can turn isolation into synergy for start up entrepreneurs

1. The institution

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The Vernus Cooperative was founded in Slovakia in 1995, with the purpose of providing access to credit to financially excluded entrepreneurs, that is, those unable to access bank finance.

2. The initiative

Entrepreneurs in Slovakia in the 1990s were faced with two restrictions regarding access to credit. One was that the formal banking sector had neither the skills nor desire to provide small business loans. The other was that there were few legal options allowing non-bank institutions to offer credit. The Central Bank of Slovakia during this period placed severe restrictions on the provision of credit by non-bank institutions. In effect, this service was limited to chartered banks, and large investment funds. There was virtually no access to credit outside these channels.

There remained a law regulating cooperatives, however, inherited from the legal code of Communist era Czechoslovakia, through which agricultural and housing was collectively held. Vernus adapted this law on cooperatives to provide non-bank credit services for financially excluded entrepreneurs.

Key features of the services are:

- An initial focus on well-performing social enterprises, extended since 1999 to women at risk, who have with little business experience
- A simple application process. A micro-enterprise client who wants to take a credit from Vernus joins the cooperative by a simple process of submitting a registration document and paying a fee of €40. If their business plan and loan application are approved, they can receive a credit of up to €2500, typically repayable over 18-24 months
- The ability for angel investors to join the cooperative and provide long-term investment capital. Typically, these are small amounts (under
There have been roughly 50 such investors over the period of the fund.

- Cooperative rules allowing members access to the financial assets of the cooperative for purposes approved by its management. In this way, Vernus became an intermediary platform for the provision of financial services between angel investors and borrowers. This approach, although an unusual use for the cooperative legal form under Slovak law, was approved by the Slovak Central Bank.

- A close cooperation with the Integra Foundation. Integra, as a not-for-private-profit NGO, was unable to provide financial services under Slovak law. By joining together, Integra and Vernus are able to combine the advantages of an NGO and a profit-making company. The business development services provided by Integra strengthened the client micro-enterprises and increased the likelihood of loan repayment.

- Investors’ risk is shared over the entire membership. No single investor places a high amount of money, and there are many such investors, so the risk is spread in a way that allows Vernus to engage in riskier debt provision than it otherwise could. Angel investors who provide capital are able to participate in a fund that provides high social impact, yet manages risk in an acceptable manner.

3. The target market

The target market includes single mothers, refugees, divorcees, women with low educational achievement, women members of minority groups, women married to chronically unemployed spouses, etc. The programme works out of four offices that allow coverage of all parts of Slovakia. As Slovakia is a very rural country, programme staff need to travel regularly, in order to reach those women who constitute the target group.

Many women come to the programme through the Integra-funded training. This includes a three-week training programme, during which they are coached in the development of a business plan. At the end of the course, less than less than half decide to continue and seek microcredit. Those that do present and defend their business plan to the Vernus management.

4. Client stories

1. Lydia

Lydia used to work as a maths teacher in the town of Vrable, but was frustrated fighting the bureaucracy and pattern of thinking in the school system which did not allow improvements to be made. She wanted to engage herself in a field where she could make her own decisions, and execute them.

Lydia had long dreamed of starting a patchwork-making business, but had three children, and after her divorce, no investment capital available. When
the Vernus training and loan programme came to her town, she joined it, successfully completed the training and received a US$2000 (€1,575) loan.

This money was invested in new sewing machines and material, and furnishing her workshop, located in the town centre. She started production in 2001. Lydia and her part-time assistant make beautiful patchwork covers and pillows that come in different sizes, patterns and colours. Perfection of detail, attractive combinations of colours and high quality of materials are typical of all her products, one of which is shown opposite.

Lydia relies on both her older children for help - her son Juraj assists with product distribution and runs the studio web site, and her daughter Petra takes care of their youngest brother Jakub. It is possible to view her products at www.patchworkstudio.sk.

2. Andrea
Andrea: “My life went along quite smoothly until the age of fifteen. I had a good home and parents that loved me and provided everything I could ever need. But things began to fall apart on the day my mother went to the hospital for surgery and never returned. My life crashed into pieces. Without warning, somebody who loved me and understood everything about me was gone. My father became indifferent to everything around him, to my brother, to me and particularly to our home.

The burden of caring for the home and family became mine. I had to do all the housework, while not neglecting my schoolwork. It was really difficult. I graduated from high school with very good grades and longed to go to college. I was admitted, yet my father refused to pay for my studies, saying a woman’s place was in the home. I was very sad but could do nothing about it.

Then I met my husband; the first good thing in my life after so many years. Still, there were challenges; I lost my job and had to spend long days all alone. I wanted to be useful and put all I had learned into practice, perhaps by owning a small electrical appliances store. This was my dream. But in my situation it is difficult to get a small business loan in Slovakia.

This is when I heard about the Vernus programme. I attended their training, wrote a business plan, and received a loan. Later I got a second loan and expanded my inventory. Business is good; I owe so much of my success to Integra/Vernus, but like the rest of my life, it’s not always easy. And so I have learned to say, “If life gives you lemons, make lemonade!”
5. How the approach reduces financial exclusion

The Vernus Cooperative target group, socially disadvantaged women seeking credit to start their own business, experience financial exclusion for the following reasons:

- They are start-up entrepreneurs, with no experience
- They typically live in areas of the country that are economically depressed, with high unemployment
- They have little or no collateral
- They have little chance of securing guarantors/co-signers

As such, these women remain financially excluded, even in Slovakia in 2006, though the country has a much wider range of consumer and other types of credit than it did a decade ago.

Since the introduction of this financial product, the following outcomes have been delivered:

- Programme participants: 668 women
- Number of new business loans disbursed: 181
- Total value of loans disbursed: $400,830 (€316,000)
- Cumulative loss rate: 9%

6. How the approach reduces social exclusion

While many people, particularly women, harbour desires to get into business, often their biggest obstacle is a sense of being alone, and without support. They have skills or products that are commercially viable. But many clients need the stimulation and support of successful examples and other people taking the same path, in order to move from concept to commercialization. The coop structure can help these clients make this breakthrough from isolation to participation. As well, in the Vernus model, collective activities (seminars, conferences, newsletters, site visits) have been very popular among clients. The coop approach helps give the sense of possibility and partnership that lone entrepreneurs often lack, and in this way helps overcome the social exclusion that is often faced by isolated and low income people who want to get into business.

7. Key learning points

1. The cooperative structure provides a good way to link small-scale investors with borrowers, which:
   a. may avoid some credit regulation requirements,
   b. spreads investors risk among a set of borrowers, and
   c. brings together borrowers and lenders in a common enterprise, with shared values, and so may reduce the imbalance normally characterises the borrower/lender relationship.
2. Marketing and sustainability of the model is best achieved where it is delivered in partnership with business development support.

3. Mass-market microfinance programmes can exclude those with no business experience, guarantees or collateral unless they are carefully designed to be accessible to this group.

4. Although not attractive to investors on purely commercial terms, investors who want to keep a portion of their portfolio in high-impact social programmes may be attracted to this kind of initiative. The long-term financial goal of the programme is to cover costs and retain portfolio value, with enough liquidity to repay investors principal plus modest interest (1-3%) within 6 months of notice of withdrawal. Such modest targets are achievable.

8. Recommendations for MFIs and policy-makers

1. Policy-makers and MFIs in Eastern Europe may wish to assess whether the cooperative structure has been overlooked in their countries as a way of bringing borrowers and lenders together.

2. MFIs in both Eastern and Western Europe may wish to assess whether the cooperative structure can allow them to offer credit under an alternative regulatory regime, perhaps reducing compliance costs.

3. MFIs may wish to consider the advantages of ensuring credit is only offered in tandem with, or following, business development support.

4. MFIs may wish to use the cooperative model as a way to attract small investors to micro-enterprise, both because risks are spread and because a close and balanced relationship may be developed between them and borrowers.
Case Study 19: Evers and Jung Telecoaching – Germany

TeleCoaching - an outbound telephone mentoring service for micro-credit customers. Lean processes and the use of modern communication enable cost-efficient business support tailored to the needs of the clients.

Telephone mentoring to start-up businesses, reducing default rates

1. The institution

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EVERS & JUNG is an international research and consulting company based in Germany. It provides advice to banks, government ministries and the media on private and small and medium enterprise (SME) finance. The sixteen-member team develops concepts and products, undertakes studies, and pilots innovative approaches in business financing and economic development. Current products include SME advisory services, consulting and international research and evaluation.

The organisation’s clients include institutions focusing on economic development, SME financing, start-up enterprise, and product quality development. They also assist small enterprises needing coaching and financial advice, and publish guidebooks on finance and financial literacy.

2. The initiative

The TeleCoaching initiative provides telephone-based post-loan business advice and support to micro-entrepreneurs. It is currently available in Hamburg, financed by the city, and offered to borrowers under the city’s micro-loan programme.

Under the initiative, coaches and entrepreneurs have telephone discussion every three months. Particular aspects of support include:

- Training in sales, marketing, and cashflow forecasting
- A quarterly status check, covering business and personal budgeting and cashflow
- Agreeing milestones for the next three months
- Advice and support on how to acquire plant and materials
- Provision of information leaflets
- Access to a database of support information
- Access to workshops on the Minicontrol software tool [see separate case-study].
The purpose of the scheme is to provide a cost-effective way of reducing default rates, by providing mentoring support to start up businesses. The intention is that regular checks, every three months, will identify problems before they become too difficult to manage.

3. The target market

The programme assists borrowers under the city’s micro credit scheme which is aimed at unemployed potential entrepreneurs. Clients are, therefore, usually disadvantaged in financial terms, and many have a lower than average level of education. There is an above average number of immigrants among the client group.

The programme has been successful in reaching this target market. By January, 2006, 237 borrowers had been recorded on the TeleCoaching database, and introductory conversations had been held with 170 of them. Thirty-five borrowers dropped out of the TeleCoaching scheme, for a variety of reasons, including lack of business success, early repayment of their loan, or a lack of desire to participate. The customer satisfaction rate is currently 90%.

4. A client story

Two women received a micro-loan to start a mortuary business. Two months after taking out the loan they were contacted by a telecoach, who provided an Excel-based tool (Minicontrol), to help them record their expenses (including private expenses), and forecast their cashflow. They prepared a report using the tool, which formed the basis for a detailed discussion with the coach. This identified that turnover was 20% below projections. The TeleCoach suggested marketing to address this, but the entrepreneurs said that it was particularly difficult in their market sector. They had used newspaper advertisements, the Yellow Pages, and seminars, with limited success. The telecoach gave them information leaflets, and advice on how to analyse client data to identify new ways of advertising.

By the time the next TeleCoaching session was held, three months later, new marketing methods had been employed, and both turnover and costs had risen. Marketing included renting display cabinets in a well-frequented subway station. The telecoach encouraged them to continue and develop their business, and advised them on ways to do this, including ways to maintaining contact with potential clients. He also provided a marketing tool.

By the time of the third TeleCoaching session, business was increasing, and in particular the subway station display cabinets had become very effective. Things continued to improve until the end of the programme, when sales were very good, despite a seasonal depression normally experienced in the sector. The entrepreneurs repaid their loan within two years and when last contacted the business was turning over 37% more than had been forecast.
5. How the approach reduces financial exclusion

The programme has assisted 170 borrowers, and 135 were still using it at the time this report was compiled. TeleCoaching had improved the performance of participating micro-entrepreneurs, and so their ability to repay their loans. The programme has not, however, been running for a sufficient time to give statistically reliable evidence of its effect on default rates.

The programme is supported by the city of Hamburg, because it provides a range of economic benefits to the city, in addition to increasing the repayment rate of loans provided with its money.

6. How the approach reduces social exclusion

Specially trained consultants offer an ongoing business support, the compensation of entrepreneurial deficits through training on the job, and the identification of crisis symptoms at an early stage. The business support helps to prevent failures of the micro entrepreneurs. If a failure of the micro enterprise can not be prevented the identification of early crisis symptoms often prevents greater loss to the entrepreneur. Social exclusion is diminished for micro credit customers with failed or failing businesses.

7. Key learning points

1. TeleCoaching is an effective way of reducing the cost, and increasing the reach, of post loan and support to micro-entrepreneurs.

2. The cost of a TeleCoaching scheme cannot be recouped from interest on loans. It may be a worthwhile investment for MFIs if it reduces default rates, but the full cost can probably only be met by a contribution from an institution interested in the economic or social inclusion benefits which it provides.

3. TeleCoaching can provide a way of identifying potential problems at an early stage. Where appropriate, a face to face interview can then be arranged.

4. Because there is little face to face interaction, TeleCoaching must combine high quality business support skills with an ability to communicate well, and provide support and encouragement, by phone. High-quality telecoaches can be hard to find, and expensive.

5. TeleCoaching is most effective when combined with a set of computer-based tools, and so is best used where levels of internet access are high among the target group.

8. Recommendations for MFIs and policy-makers

1. There is an increasing awareness throughout Europe that successful micro-finance depends upon good pre-and post-loan support. The TeleCoaching programme offers a way to provide this at a lower cost than through face to face meetings.

2. MFIs would benefit from the TeleCoaching programme, provided that it helped reduce default rates. The costs of the programme are
considerable, however, and would need to be borne by institutions which value its economic benefits. MFIs and policy-makers may wish to discuss how they can finance the programme between them, so that each obtains the results it needs.
Case Study 20: Evers and Jung - Minicontrol – Germany

A controlling and business support software specially developed for micro and small enterprises. It is easy to use, modular and generates first results quickly to motivate as many entrepreneurs as possible to do basic financial planning.

**Software offering simple cash-flow monitoring and business overview mechanism**

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EVERS & JUNG are an international research and consulting company based in Germany. Their activities are noted in detail in the first section of the Telecoaching case-study, above.

Some years ago, the company identified a need for a simple tool which allowed entrepreneurs to process financial information, and obtain a snapshot of their business situation. They developed the Minicontrol product to meet this need, and tested it over an extended period.

2. The initiative

Minicontrol is a computer-based business support tool for micro-entrepreneurs employing between one and ten employees, and start-up businesses. It is designed to overcome the reluctance of many small scale entrepreneurs to record their financial transactions properly, or address key business needs, such as marketing and ordering, in a systematic way. Entrepreneurs can learn to use it within two hours, and it does not require accounting skills.

As well as recording financial transactions to produce a statement of account, the tool provides a business assessment report. It is divided into six basic modules, covering: household budgeting; business cashflow; financial planning; order or project control; marketing and business assessment. Additional modules cover production cost calculation, telephone sales, liability assessment and levels of customer interaction.

Other features of the tool include: an integrated assessment of enterprise and private financing; budgeting, an automatic rolling assessment of input tax, a lack of technical language, and a reliance on cashflow rather than accounting movements.
The tool automatically generates simple overviews on a single sheet of A4, which demonstrate the status of the business. The overviews highlight any potential problems, and this ability to identify issues before they become problems is one of the tool’s key benefits.

The next two figures show the key menus used by the tool.

Figure 1: Minicontrol Main Menu

Figure 2: Minicontrol Cash Flow Planning Module
3 The target market
In the context of microfinance, the target market is small scale and start-up entrepreneurs, with limited financial and computing skills.

4 A client story
Mr. X was a second starter who set up a new business in the name of his wife, after his first venture went into insolvency leaving him owing nearly €2 million. His new business was selling high quality hairpieces, and it grew rapidly because he is a very gifted salesman. After about a year he had a monthly turnover of about €10,000, but he always had cashflow problems. That was when he started to use Minicontrol to plan his cashflow. He soon became a keen use, and started to enter income and expenditure daily. This helped him to keep an up to date overview of his accounts. The ability to see at the end of each day what the position of his business was acquired a symbolic importance to him.

He then moved on to entering new orders onto the system, with planned payment dates. This gave him an overview of which payments he could expect in the next month, and so he could make sure his planned expenditure matched projected income.

After working with these figures for a while he really started to understand the financial mechanics of his enterprise. As a result he was able to increase his turnover, which is now over €50,000 per month. He also increased his profitability.

5. How the approach reduces financial exclusion
Minicontrol reduces financial exclusion to the extent that it permits disadvantaged entrepreneurs to understand their financial situation and control cashflow. This reduces the chance that their business will fail.

6. How the approach reduces social exclusion
Minicontrol increases financial and business literacy skills of micro entrepreneurs. Increased skills in these areas help to prevent failures of micro enterprises and subsequently social exclusion.

7. Key learning points
1. A simple financial modelling tool can be very effective in helping entrepreneurs understand their business.
2. Once created, such a tool is comparatively inexpensive to provide to entrepreneurs.
3. The tool could be offered in other countries, once its instructions and field descriptions are translated, and changes are made to reflect differences in the levels of tax etc.

4. The tool requires a computer, and basic computer skills, on the part of the entrepreneur. An internet connection is useful but not essential. The tool can, therefore, be applied in many contexts in both Eastern and Western European countries.

5. The tool offers a way to lower the cost of post-loan support, by providing loan officers with the information they need in a standard format. This reduces the sometimes considerable cost of the loan officer asking for additional information.

8. Recommendations for MFIs and policy-makers

1. MFIs could consider Minicontrol, or a similar tool which they develop themselves, as a way of reducing post-loan mentoring costs, and default. They may find it more cost effective to purchase such a tool, rather than develop it.

2. Minicontrol is likely to be most effective where offered as part of a comprehensive post-loan business support package. This will increase the likelihood that borrowers will use it over a sustained period.

3. Minicontrol can help loan officers by providing an early warning where the business is encountering difficulties, which might mean the loan will not be repaid on time.
Case Study 21 - Microfinance for miners from the depressed former mining areas of Romania.

*How does the use of combined micro-lending methodologies contribute to the creation of new job opportunities?*

1. The institution

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This case study aims to stress the role of microfinance in targeting the excluded groups from the former mining areas in Romania. The two microfinance institutions that will be presented in the following paragraphs are CHF International Romania and Economic Development Center (CDE – Centrul pentru Dezvoltare Economica).

*CHF International Romania*

CHF International Romania is one of the largest credit providers to micro-, small- and medium-sized enterprises (MSMEs) in Romania. They provide loans to private businesses, family associations, housing associations and individuals. In recent years, the CHF International Romania loan program has made $32.5 million in SME and housing loans and created or sustained over 32,000 jobs.

*Economic Development Center*

Economic Development Center is a Romanian non-governmental organization, dedicated to assist the development, investment, growth and success rate of businesses. The center is a member of the Soros Open Network (SON).
CDE mission is to promote the economic development of micro, small and medium sized enterprises, by providing entrepreneurs with one-stop source of business information, support (through training sessions and consultancy services) and financial products, in order to address the needs of an expanding market and to enhance the clients' ability to make profitable use of the economic activities they run.

2. The initiative

The implementation of the Mine Closure and Social Mitigation Project started in January 2000 and the Project closed on October 31, 2006. The targeted sector aimed by the Project was the mining sector. The total financing provided by the World Bank for this project was US$ 44.5 million. The Project consisted of several components, among which providing support to the unemployed by establishing and piloting mechanisms for employment promotion, such as:

- Micro-credit scheme;
- Creating of workspace centres;
- Enterprise Support services;
- Employment and training incentive scheme;
- Public information and social dialogue.

Within the social mitigation component of the Project, a micro-credit scheme has been created in order to respond to the articulated need for micro-credit to encourage micro-enterprises in an environment where credit was severely constrained by unrealistic collateral requirements.

The main technical issue has been to ensure that the micro-credit scheme functions in line with good international practice. Romanian micro-credit legislation was prepared under the pilot project, which laid the legal basis for non-profit microfinance institutions (MFIs) to be contracted by government agencies to administer micro-credit programs. Furthermore, in July 2005, the Romanian Parliament approved the Microfinance Law which requires MFIs to register as commercial companies.

The Micro-Credit sub-component is administered by MFIs contracted by the National Agency for Development and Implementation of the Reconstruction Programs in Mining Regions (NAD) through international bidding and supervised by NAD. The two MFIs selected to manage the funds of the micro-credit scheme were the Economic Development Centre (CDE) and the Community Housing Foundation (CHF).

At present, all contracts for management of the micro-credits fund have completed the inception phase. Both CHF and CDE have established operational offices in 11 localities, which cover all the 14 mining zones (see map below).
Areas of implementation of the Mine Closure and Social Mitigation Project
(Colors indicate the locations of the microcredit beneficiaries)

The Mine Closure and Social Mitigation Project was designed for the mining areas in Romania affected by the mine closure process undertaken by the government. The project goal is on one side to reduce the environmental impact of the closure of mines and, on the other side, to develop the communities in this area.

The innovative approach of the project was to support the provision of micro-loans through the Micro-Credit Scheme with other business development services. Therefore, the Micro-Credit scheme represented the so-called “hard component” of the project, which was backed by a “soft” component. The latter was represented by the workspace centers and enterprise support services, the employment and training incentive scheme and the public information and social dialogue, whose role is to
increase the entrepreneurial spirit and to facilitate reorientation of former miners.

Another element that is considered specific to the project and which contributed to the successful implementation of the Project is the use of partnerships.

The main partnerships settled for this project were the partnerships with the Romanian Chamber for Commerce and Industry, the professional associations and the local authorities. These partnerships had a double role: on one side they provided key information for the microfinance institutions on their potential clients and on the other side they contributed to the promotion of the project. The partnership with the Romanian Chamber for Commerce and Industry was of particular importance as the MFIs could get information on the potential borrowers, so that in this case, the partnership worked as a pre-screening tool.

Within the micro-credit sub-component, the partnership was the basis in ensuring the moral security of each micro-loan. The creation of “Business Associations”, according to the crediting methodology of CHF International Romania facilitated the creation of a pressure group whose main purpose is to ensure the reimbursement of credits on time. In a similar way, the crediting of informal groups by the Center for Economic Development extended the concept of partnership at the level of the individuals in the mining communities whose main aim is to access, use and reimburse the micro-loans.

3. The target market

The labour force in the mining areas was always privileged with higher wages and non-wage benefits as compensation for difficult working conditions. However, restructuring of the mining sector, initiated by the Romanian government in August 1997, has had a negative effect on the involved local economies where large number of miners were employed. Therefore, the Mining Closure and Social Mitigation project targeted not only laid-off miners after restructuring of the sector, but also other residents in the mining communities who have also been affected by the related downturn in the local economy. All residents of the affected communities could participate in the diversified enterprise development activities.

Another targeted group were women, especially through the micro-credit and enterprise support programs. Both micro-finance institutions, CHF and CDE are active partners in the micro-credit, enterprise support, and social dialogue subcomponents of the social mitigation program.

The graph below shows the overall distribution of loans by size and by microfinance organization. The differences are due to their different approaches and related target groups. While CHF targets officially
registered businesses, CDE targets mostly individual members of community groups.

Numeric distribution of loans by size and by credit agencies, as of September 13, 2006

4. A client story

Community Housing Foundation – ‘CHF Provides Funding at Critical Moment’

Eugen Zippenfenig is a young entrepreneur in Petrosani, Valea Jiului mining area. In 2003, he decided to start his own business in order to improve living standards for his family. His wife tells us: “When Eugen told me what he had in mind, I was not at all convinced of the probability to
earn some money: he intended to open a hair-dresser and barber's shop and to offer cosmetic treatment for men!!"

The money they earned in the first six months were all re-invested into the business - they renovated the beauty parlor. In spite of that they still needed some financing to buy new equipment for facial treatments. After searching for different options, they turned to CHF International Romania where they received a first loan of Euro 5,000, to buy the equipment.

In August 2005, they applied for a second CHF loan, at Euro 7,000, and that they finished all renovations and decorations to the beauty parlor.

Eugen Zippenfenig confesses he also appealed to banks, but only CHF offered a two-year loan and accepted him as client (although he had only six months of business experience).

As a result, Numero Uno Euroline Ltd. became one of the favorite meeting places for people in Petrosani, while having haircuts, being shaved, having nails polished, hair dressed. Valentina and Eugen also employ four people to deliver these services.

Thanks to Eugen’s entrepreneurship, Valentina’s support, the high quality of the services, expert staff, and the timely financing of Numero Uno Euroline Ltd., this company has a rosy future.

Economic Development Center – The Case of Ms. Ana Canut

Ms. Ana Canut is living in Baia village, in South-Eastern Romania, a depressed area, of no industrial interest, where agriculture is the main occupation and source of income.

Ms. Canut used to work as a house painter. Five years ago, she had a work accident, which prevented her going back to her job.

She didn’t have any other qualifications and the labor market in the area was very scarce, so social allowance was a blessing. The only working person in her family was her husband, but he earned just a minimum wage. The family could not survive on such meager resources.

Ms. Canut’s father was a shepherd and she remembered from her childhood, that a few sheep well bred could provide a decent income for a whole family. The idea of starting a small sheep farm seemed brilliant and the family started
looking for capital for the start-up at financial institutions. Unfortunately, due to their low income and lack of guarantees, no bank was interested in granting a loan to the Canut family.

It was only the Economic Development Center (CDE) that made their dream seem possible for the first time. Because of the CDE methodology that enables microcredit granting considering moral guarantees, the Canuts received a 1,000 Euro loan to start their farm. The loan was granted, as the community recommended Ms. Canut as a very serious and hard working person. The flexible reimbursement schedule proved a real help for the new entrepreneur and in 2005 she qualified for a new loan of 2,000 Euro which enabled her to buy more sheep and extend the farm.

At present, her family has almost 100 sheep, and they have plans of expansion. They became the main providers of sheep products in the village. During the year this is milk and cheese and lambs in spring. Mr. Canut is still working for the minimum wage, but the three sons of the family start every day planning the activities and sharing the responsibilities at their small farm.

5. How does the approach reduce financial exclusion

The Mine Closure and Social Mitigation project contributed to the reduction of financial exclusion in two ways.

One one side, the Micro-Credit Scheme represented for the entrepreneurs in the former mining areas the only source of finance. Given the very low economic development of these regions, banks have little interest in opening branches here, so that the offer of financial services is limited. More than that, banks are not interested in extending loans to start-ups or very small enterprises, as they consider them both to risky and expensive. Therefore, the micro-loans provided by CHF and CDE provided entrepreneurs in these areas with the necessary funds to start and develop their own businesses.

On the other side, the development of new businesses contributed to the creation of new jobs. Thus, people who were previously unemployed, with no source of income, have now become bankable. By being able to prove that they work and that they have an income, they have access to consumer loans, offered by the several banks operating in these regions.

At the end of the Project, an overall decrease or stabilizing of the unemployment situation in mining zones was registered. Almost all 20 counties selected for the implementation of the Mine Closure and Social Mitigation Project registered a decrease over the previous three years.
The Micro-Credit scheme had a significant impact on sustaining household livelihoods through self-employment and income generating activities. Over 6000 jobs were created and sustained. In terms of laid-off miners or other categories of unemployed, the project reached only a limited number. However, this only suggests that the Micro-Credit Scheme is a good instrument to support economic regeneration of mining communities through job creation, rather than a means for individual rehabilitation of former miners.

6. How the program reduces social exclusion

The program contributes to the reduction of social exclusion by targeting former mine workers as well as other people in the mining areas, affected by the closure of mines. As these are all mono-industrial areas, the process of creation of new jobs is rather slow. However, through the Micro-Credit Scheme, people in these areas have the opportunity to start new businesses or develop existing businesses which also leads to the creation of new job opportunities.

Another way in which the program contributed to the reduction of unemployment is by offering new opportunities for women in these areas. Although the program didn’t target women specifically, the number of women accessing funds from the microfinance institutions was higher than expected. As it can be seen from the chart below, the participation of women in the scheme was of 35.57%, while at country level the percentage of women entrepreneurs was only 30% in the middle of 2006.

This result is important to mention as women in these areas can not be characterized as very entrepreneurial. As mining was the main activity in
These regions, there were never many opportunities for women. However, the employment and training incentive scheme, as well as the public information and social dialogue activities of the "soft" component of the project helped them develop their entrepreneurial skills and the Micro-Credit scheme gave them access to finance needed to start their own business.

7. Key learning points

1. One important learning point is the use of different approaches and methodologies (like the group lending methodology used by CDE or the creation of "Business Associations" promoted by CHF) so that both individual entrepreneurs and existing enterprises could benefit from the program and generate self-employment as well as new job opportunities.

2. Combined measures; micro-credit activities were accompanied by training activities aimed at developing the entrepreneurial spirit, as well as by the creation of workspace centers.

3. Essential element for a positive impact of the project was represented by the creation of partnerships, mainly at local level, whose role was to support the economic development and to promote the actions developed within the project.

4. The main challenge was to provide micro-credits in areas where people had no credit mentality. They were expecting for someone to give them the necessary funds for free, rather than to borrow. This approach implied another challenge which was to make the mining communities understand the business-oriented character of the micro-credit and not to see it as a consumption loan.
5. Although the project had positive results, there were several aspects in its implementation that did not work well. First of all, there was a slow start-up of the micro-credit scheme, which lasted more than 8 months, especially due to administrative issues related to the disbursement of the loans. More than that, due to the small size of the funds available compared to the total number of eligible localities, several localities did not benefit from the Micro-credit Scheme.

6. In order to overcome these issues, certain adjustments had to be made to the project implementation. Firstly, in order to simplify the flow of money to the beneficiaries, the State Treasury through which funds were initially disbursed was replaced by commercial banks. Then, in order to expand the reach-out of funds, there were new contracts signed with the two selected MFIs that would allow them to operate in other areas, than those originally selected (at the beginning, there were 5 contracts, each for one operating area).

8. Recommendations

In *Eastern Europe*, the use of similar projects in the mono-industrial areas affected by restructuring processes would contribute to a faster development of the respective area.

In *Western Europe*, a positive impact could have the use of the lending methodologies used in the project presented here (Individual lending, group lending and group guarantee lending methodologies). Moreover, the combination of micro-credit activities with other business support services could contribute to the entrepreneurship development, business development and self employment of the targeted social excluded groups in Western European countries.

7. Annexes

7.1 *Annex 1 – Working group members*

1. Inger Berggren, WWB, Spain
2. Allan Bussard, Integra, Slovakia
3. Grzegorz Galusek, MFC, Poland
4. Martin Jung, Evers and Jung, Germany
5. Kostadin Munev, Jobs Project, Bulgaria
6. Andrew Shadrake, cdfa, UK
7. Agata Szostek, MFC, Poland
1. DEFINING SOCIAL AND FINANCIAL EXCLUSION

Working Group 4 started its work on reviewing the work which WG1 had done, following their debates on definitions and indicators in the context of the respective networks. Group members also had the chance to look at the existing literature on social and financial exclusion and EU Eurostat data and indicators on social exclusion.

2. DEFINING WHAT IS INNOVATION

When discussing various examples of innovations, the group agreed that we should consider two perspectives.

One could be an innovative approach to existing products and services. The other type of innovation we would like to look at is the product or service itself.

The Case Study should incorporate one of these, or both.

The Case Study should present an innovation which has proved itself in the given environment, with the emphasis on how it contributed to decreasing financial and social exclusion, in particular:

→ How the specific product/service contributes to enterprise creation.
→ How the certain product/service or approach supports enterprise development (in this job creation) or allows it to remain on the market.
→ How microfinance operates in disadvantage communities with a history of exclusion (innovative products/services/approaches).

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<thead>
<tr>
<th>TWO PERSPECTIVES ON INNOVATIONS</th>
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<tbody>
<tr>
<td>APPROACHES</td>
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<tr>
<td>Mobile banking</td>
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<tr>
<td>Adapting to ethnic minority culture (Roma population, immigrants, socially excluded people, etc.)</td>
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<tr>
<td>Women and men (women only)</td>
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<tr>
<td>Combining products (loans + insurance; various types of loans combined ;)</td>
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<tr>
<td>Combining products and services (loans + BDS)</td>
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<tr>
<td>Unconventional collateral</td>
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<td>Unconventional guarantees (honorary guarantee)</td>
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<td>Intermediate equity funds</td>
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3. IDENTIFICATION OF PRODUCTS/SERVICES TO BE PRESENTED IN THE CASE STUDIES

The group decided to look in their respective countries for examples of innovation in order to create a pool of potential products or services/approaches which could be described and presented in the final report with recommendations for implementation either in the East or West of Europe.

This pool will be formed on the basis of group members networking activities.

The group agreed that in order to create the pool of innovations from which the most valid ones shall be selected a common format is to be followed.

The initial description of the innovation should be very short (not more than 1 page) and should include the following:

1. Short presentation of institution/program which has implemented the innovative product/service/approach?
2. Product/service/approach characteristics.
3. Who is the target client for this product/service?
4. How is the product/service/approach supposed to contribute to the reduction of financial and social exclusion?

The above mentioned points should also serve as guidelines for gathering data from respective microfinance institutions identified through personal networking.

4. CASE STUDY OUTLINE

The group also agreed on the Case Study outline.
A Case Study should take not more than 3-4 pages, and should incorporate the following points:

1. Presentation of institution/program which has implemented the innovative product/service/approach?
2. Product/service/approach characteristics.
3. Who is the target client for this product/service?
4. Example (illustration on how the innovation works by presenting a client story)
5. How the product/service/approach reduces financial exclusion?
6. How is the product/service/approach contributes to the reduction of social exclusion?
7. Main learning points
8. Recommendations for West/East.

5. SOCIAL EXCLUSION

To underline the social exclusion aspect in the case studies presented in our WG report, we brainstormed several aspects:
- Does the service/product/approach serve or could it serve inclusive lending
- Discrimination aspect; how/if potentially can it overcome discrimination (working with certain market segments pushes them to be less excluded, i.e. villages, minority groups)
- How does it affect market exclusion
- bds is a way to overcome exclusion for the micro entrepreneurs, IGAs cannot afford access to costly expertise
- job creation, in this self-employment

As a result, we agreed to look how the examples presented in our case studies help combat social exclusion from the following perspectives:
1. Access to finance (but this is already covered in the financial exclusion paragraph)
2. Access to markets
3. Access to bds
4. Access to employment
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