Note to DGFISMA

Capital markets Union and the development of microcredit for an inclusive entrepreneurship

One of the main issues of the capital markets union is to unlock financing of innovation, enterprises, and especially SMEs and start-ups. In a situation where, 92% of European enterprises are microenterprises of less than 10 employees[1] (many of them having no employees) and where start-ups include a growing part of unemployed, it seems important to include these "missing entrepreneurs" in the total demand of the capital market, knowing that many of them are excluded from access to banks. This is the context for development of microcredit in support of growth and employment, which is in itself a social innovation on behalf of an inclusive entrepreneurship.

2. Shortfall of the microcredit market

At this stage there is as yet no real market for microcredit, which is largely developing as a function of supply. In the *European Initiative for the Development of Microcredit in Support of Growth and Employment*[2], potential demand is estimated on a base of 60% of the population below the poverty line aged between 16 and 64 years, which for EU-27 currently represents 712,900 microloans, in the amount of €6.15 MM. This estimate is very approximate and does not include the demand of people who are financially excluded without necessarily falling below the poverty line, as well as that of existing microenterprises, which do not all have access to banks. Supply only serves a small part of this demand, which itself is underestimated, inasmuch as, according to the last study of the European Microfinance Network, the number of microloans provided in 2013 was on the order of 387,812 for a total amount of €1.52 bn. The number of microloans has increased by over 400% since 2009 and the amount has more than doubled. Close to 79% of the loans provided in 2013 went to an income-generating activity, while 21% were made for consumption.

This rapid growth of microcredit is confirmed by the report of the Commission for the establishment of PROGRESS and "The study of imperfections in the area of microfinance and options for treating them by an instrument of the European Union". The study conducted by Evers&Jung establishes the size of the unsatisfied demand and advocates the development of microcredit. Updating the European Commission's estimate in the *Initiative for the Development of Microcredit* (2007) yields a potential demand of 1.2 M microloans for EU-28 in 2012, for a total amount of €8.6 bn.

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[1] See Annex

[2] Brussels, 13.11.2007. COM(2007) 708 final "Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions"

This shortfall of the single market in Europe as a whole is all the more regrettable as the cost of a job created by microcredit if of the order of €1,500 as against from 6 to 12 times as much for a subsidized job/year, for the direct cost of a jobless person/year and for the cost of creating a job in an industrial park. The total annual cost of a jobless person (including administrative costs and foregone government revenue) varies according to country between €18,000 and €33,000. Thus, by removing obstacles to the development of microcredit, Member states not only contribute to creating low-cost and local market jobs. They also realise economies in regard to passive expenditure on unemployment and receive a modicum of tax revenue from the enterprises and jobs created. For example, an impact study, elaborated by Vlerick Business School in Belgium in 2014, shows that the Federal and Regional Governments saved approximately €1 M in allocations and gained approximately €1 M in taxes and social contributions in turning 300 unemployed people into entrepreneurs.

3. Initiatives already undertaken:

The *European Initiative for Growth and Employment* published in 2007 proposes four axes of development:

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

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

In contrast, progress in regard to the legal framework of microcredit and microenterprises, which currently falls under Member Countries' government responsibility, has been very limited and at EU level has not made it possible to respond to the financial needs of the self-employed and micro-entrepreneurs lacking access to banks.

Thus, we are proposing to undertake, in the coming months, a study to update the *European Initiative for Development of Microcredit* published in 2007, making it possible to define the rules that are common to all member countries, pointing towards filling the market gap that currently exists all over Europe.

Among these common rules the following can be cited, *à priori*:

1. Revise the definition of microcredit which is today limited to a maximum amount of € 25,000, in order to:
    - better differentiate from bank credit,
    - making it correspond to real needs of financial inclusion by specifying the target excluded population and/or and the ultimate social objective,

- including “business development services” alongside microcredit in the definition of microfinance.

2. Consider what can be harmonized across the existing variety of legal frameworks in all Member States, and in particular, authorize more generally the creation of nonbank microfinance institutions (MFIs) that can finance income-generating activities for individuals lacking access to banks,

3. Consider with Central Banks the possibility to review the rules applying to microfinance institutions so as to
   - separate social credit operators from commercial ones
   - integrate the EU Code of Good Conduct,
   - be proportional to operator's size and social mission
   - provide access to credit bureaus or similar databases;

4. Ensure that regulations on free circulation of capital and services apply to microcredit, e.g. allowing MFIs to operate throughout the EU, whether in providing cross-border services or creating agencies in other member countries

5. Allow institutions such as “credit unions”, to collect savings and to finance not only social inclusion personal credit but also income-generating activities,

6. Review the issue of ceilings on interest rates to make sure they meet both the needs of the clients and the cost cover of MFIs,

7. Expand EU Consumer protection regulation (The Consumer Credit Directive on credit agreements for consumers) focusing on transparency and consumer rights to include both consumer/personal and business credit services extended to excluded target populations.

4. Short-term, urgent initiatives

The current situation regarding the legal framework of microcredit varies widely:

- Countries where microcredit is organised by the government, ex: Sweden, Finland,
- Countries where the legal framework allows the creation of nonbank microcredit institutions, ex: Great Britain, Belgium, Poland,
- Countries where the banks enjoy a monopoly that leads to complicated partnerships between MFIs and banks, ex: Greece, Germany…
- Countries where the banking laws have been amended to allow the development of microcredit, ex: France, Italy, Romania.

The objective does not necessarily consist in unifying the legislation of all member countries, but rather in removing the main obstacles noted in paragraph 3 where they exist, by establishing a minimum legal framework to be respected by all.

Based on the situation of the different member countries noted above, which has not fundamentally changed since 2012, and on the *European Initiative for the Development of Microcredit* and its updating, DGFISMA could propose this minimum legal framework to all the member countries.

5. Longer-term objectives

Beyond short-term initiatives and those already undertaken, long-term objectives should seek to reflect more deeply the evolution of the European economy, necessarily leading to significant changes in the organisation of enterprises and labour, on the one hand, and on the other hand, in the capacity of the welfare state. As a follow-up to the study published in 2014 by the OECD and the EC on «*Missing entrepreneurs: policies for inclusive entrepreneurship*», the EC should complete the adaptation of the legal framework of microcredit (and microenterprises) to the changes described there.

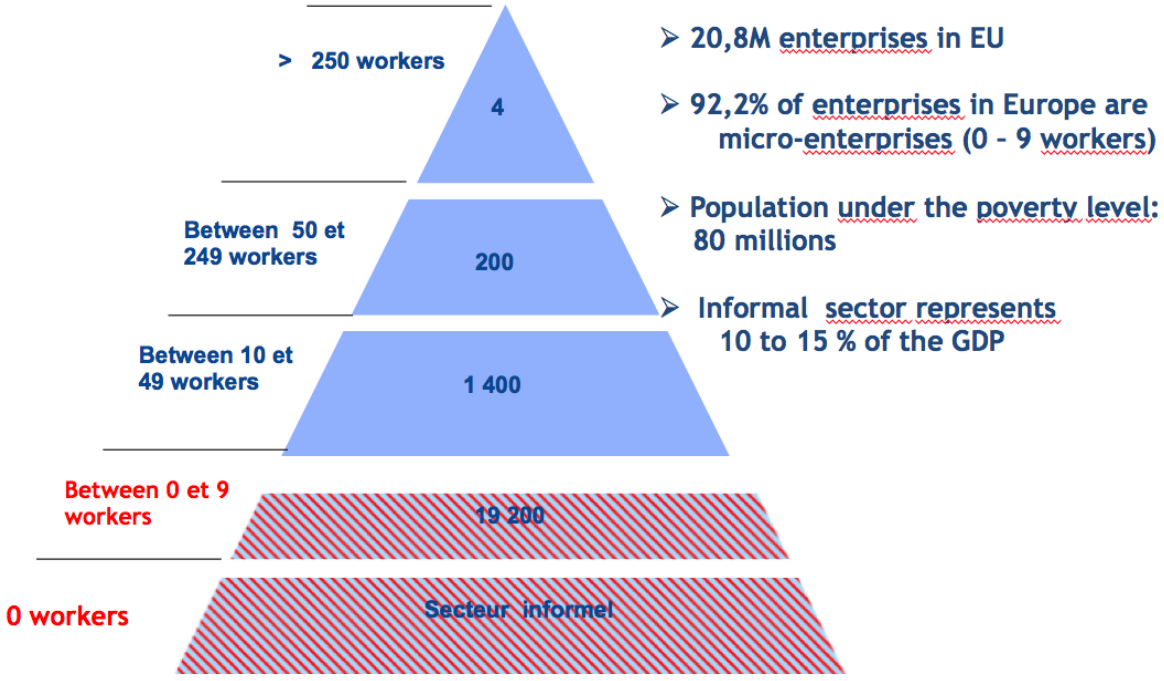
Conclusion

Considering the current importance and rapid development of microenterprises and self-employment (see Annex), it is important, from the viewpoint both of employment and of suppressing an important market failure in many Member States, that the Capital Markets Union should also include microcredit. Meanwhile we are advocating with DG Employment the same cause in regard to the legal framework of self-employment and microenterprises. This adjustment of the legal environment to support initiative from all economic actors lacking access to banks – jobless, welfare recipients, refugees, etc. – could have an important impact on the effectiveness of financial instruments being developed in parallel.

Annex: Importance of microenterprises in Europe

- Contrary to conventional wisdom, the vast majority of enterprises in Europe, or 92% of the total number of enterprises, are microenterprises with less than ten employees.

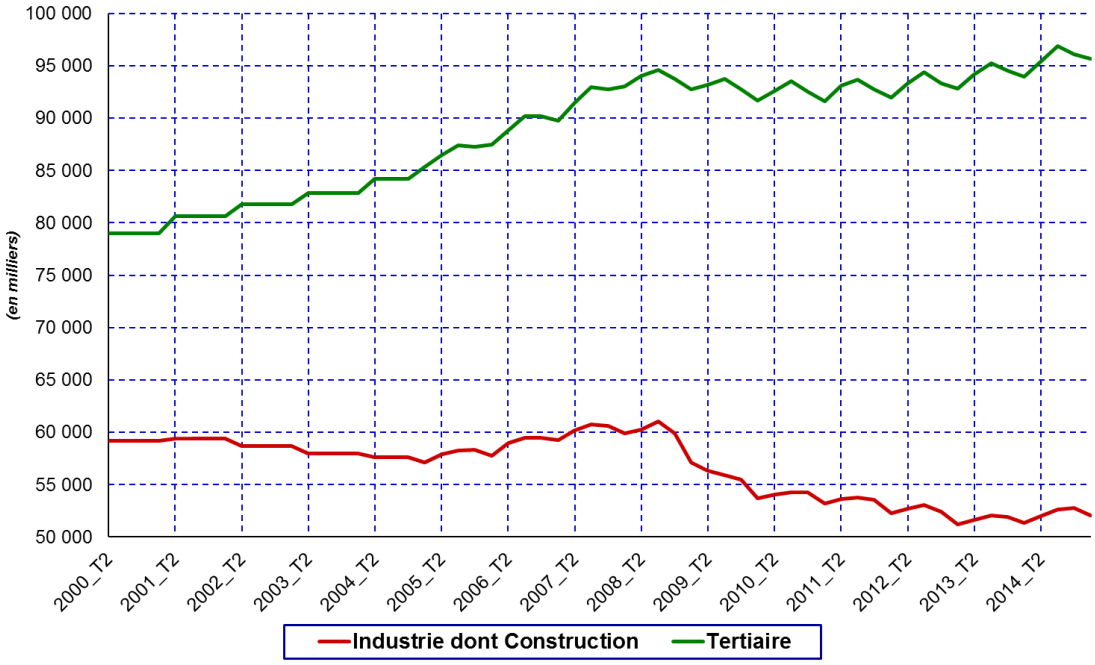
Distribution of enterprises in the European Union



- Among these microenterprises, a large part has no employees.
- The evolution of the European economy is based on four principal trends:
  - Expansion of the digital economy
  - Deindustrialisation and development of services
  - Ageing of the population
  - Immigration

These trends favour the creation of small production and services units.

Évolution comparée des effectifs salariés de l'industrie et des services dans l'UE 27 entre le T2 2000 et le T1 2015 *(source : Eurostat)*



- In many countries, creation of enterprises is becoming the main source of employment.
- A significant part of creators of enterprises come out of unemployment and have no access to banks.

Microcredit is thus becoming the financial instrument of the new economy at the bottom of the pyramid.