Microfinance and Business Start-ups: Review of the Current Practice in Europe

Research Paper

Justyna Pytkowska, Piotr Korynski
Microfinance Centre, Poland

Abstract

The paper explores the theoretical background and the emergent evidence related to the role of access to finance for business start-ups and self-employment in Europe, with a specific focus on the role of microfinance institutions. So far, microfinance has been supporting start-ups at certain maturity level on a limited scale, with only a handful of institutions fully dedicated to new ventures. The paper reviews the role of finance from the economic theory perspective drawing on the key lines of research related to entrepreneurship and financing constraints. The general research findings are contrasted with the current state of entrepreneurial finance at the EU level corroborated by a limited field research of entrepreneurship ecosystem in the select countries in Europe. The paper summarizes opportunities and challenges faced by the microfinance sector to more deeply engage the entrepreneurship and start-up financing market. Options for larger engagement of the microfinance institutions in the start-up segment close the paper offering several policy recommendations on the EU and individual member state levels to support a greater role of microfinance institutions in financing business start-ups by the excluded groups.

Table of Contents

Abbreviations

EaSI	Employment and Social Innovation
ECA	Europe and Central Asia
EIF	European Investment Fund
EMN	European Microfinance Network
ESF	European Social Fund
EU	European Union
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden
GEM	Global Entrepreneurship Monitor
KfW	Kreditanstalt für Wiederaufbau
MFC	Microfinance Centre
MFI	Microfinance institution
MKF	Mikrokreditfonds
NBFI	Non-bank financial institution
NGO	Non-governmental organization
OECD	Organisation for Economic Co-operation and Development
SAFE	Survey on the access to finance of enterprises
SME	Small and medium-sized enterprises
STEM	Science, technology, engineering and mathematics
SULCO	Start-up Loans Company
TEA	Total early-stage entrepreneurial activity
UK	United Kingdom
US	United States
USAID	United States Agency for International Development

List of Figures and Tables

1. Key Messages

Ecosystems:

- No uniform start-up definition, typically a firm that is less than 6-12 months in operations or less than 2 years
- Start-up ecosystems exist in all countries and offer varying support for start-ups
- Different priorities for entrepreneurship and start-ups in the member states

Entrepreneurs as MFI clients:

- 14% of current microfinance borrowers are start-ups

MFIs involvement in startup market:

- 77% MFIs in Europe declare support for start-ups
- 37% MFIs have more than 100 start-up clients
- 26% MFIs have more 50% start-ups in their portfolios
- 23% MFIs do not work with start-ups at all

Entrepreneurial support for start-ups by MFIs

- 58% MFIs follow an integrated approach to microfinance with BDS
- 27% of clients receive start-up support

Challenges for greater involvement by MFIs

- Policy and regulation
- Risk management
- Costs of working with start-ups
- Skills and knowledge related to new venture creation

2. Introduction

2.1. Start-ups, Self-employment and Entrepreneurship

New business ventures come in various shapes and forms, and each type requires a different support ecosystem and policy. In general, there are six types of entrepreneurs[1] starting a business venture, depending on the vision and objective for which it is initiated: *lifestyle business*, *small business, scalable start-up, buyable start-up, large company,* and *social enterprise.* All individuals who start these ventures are 'entrepreneurs' because they all step out of their secure paid employment and take risk associated with operating on their own. Classifying them into 'true' entrepreneurs, self-employed or small business owners, as this is often done, may be interesting for academic research but it offers little help from the point of view of making funding decisions and designing an appropriate the ecosystem to support the new ventures[2]. Table 1 presents the key features of various types of business ventures reflecting the motivation for the entrepreneurs to start them.

Table 1: Types of business start-ups

Type of Start-Up	Key Driver	Description
Lifestyle	Work to live my passion	A lifestyle entrepreneur is living the life they love, works for themselves full time or part time, while pursuing their personal passion. She or he starts business activities
Small business	Work to feed the family	Often family businesses, barely profitable, small businesses are not designed for scale, but rather to feed the family.
Scalable	Born to be big	Silicon Valley type of enterprises have the vision to change the world.
Buyable	Born to flip	Often web and app start-ups, they are founded to be sold to larger companies.
Large scale	Innovate and evaporate	Growth through sustaining innovation, offering new products that are variants of core products.
Social enterprise	Driven to make a difference	The goal is to make the world a better place, not to take market share or to create to wealth for the founders.

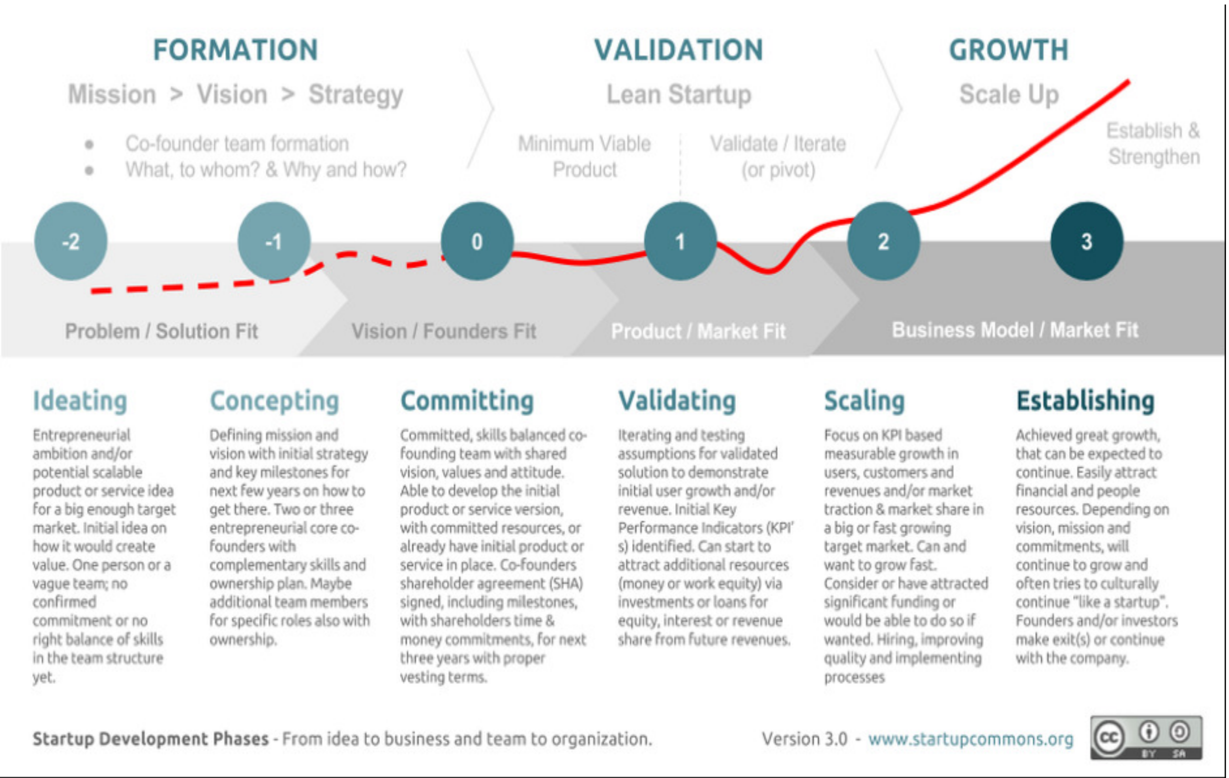
While this classification is straightforward, what in practice is considered a start-up by banks and microfinance institutions is less clear. Starting a business venture is hardly a one-shot game. Rather, it is

[1] Steve Blank, source: https://www.xconomy.com/san-francisco/2011/09/01/why-governments-dont-get-startups-or-why-theres-only-one-silicon-valley/?single_page=true

[2] This view differs from those that make a distinction between self-employed and entrepreneurs. In our view, these categories are not mutually exclusive: an unemployed person may become self-employed and be highly entrepreneurial and create a scalable business. However, we acknowledge that most self-employed will fall into the 'lifestyle' and 'small business' category.

an iterative process that falls typically into three phases: formation (including ideation, concepting and committing), validation (including seed/development and actual initiation of a business activity associated with making a sale and getting the first paying customer), and growth. Most banks and microfinance institutions are not engaged with businesses in the formative early stages, and may only start offering loans when a business has been in operation continuously for at least 6 months, if not longer - for one to two years.

Figure 1: Stages of business development



Source: https://www.smartcompany.com.au/startupsmart/advice/business-planning/the-difference-between-startup-incubators-and-accelerators/

Although there is no official definition of a start-up or early stage business, financial institutions typically define them as firms operating for less than 6-12 months and in some cases longer, especially for tech start-ups. Such firms are considered very early stage businesses and are not funded by financial institutions. Firms older than 6-12 months are typically treated as regular businesses. However, for government programs and public support institutions, the definition of a start-up is often extended to 2 if not 5[3] years of continuous operation. Such programs have higher ability to absorb risks and offer more support for new businesses. Government programs also may include the very early stage of businesses not funded by financial institutions. Forbes reports grim statistic, based on Bloomberg research, that of every 10 businesses, eight fail within the first 18 months.[4]

[3] In Italy, the law defines a start-up as an innovative company of up to 5 years.
[4] https://articles.bplans.com/6-reasons-your-small-business-will-fail-and-how-to-avoid-them/

The rationale for lack of financial institutions' involvement is that businesses need to have positive cash flow to be able to repay debt, and if this is not the case, they need to find other forms of funding (patient capital) that does not have the requirement of immediate and recurring payments over time . In addition, start-up risk may be too high to absorb for banks that need to safeguard deposits and MFIs to protect their equity base. At the same, most traditional financial institutions are not geared to providing business advisory or other business support for the new venture although increasingly microfinance institutions and banks introduce some forms of business services to assist their potential clients with their businesses.

Such an approach to financing of early stage businesses clearly leaves out those in the pre-venture stages which need to find finance elsewhere to get off the ground. Typically, new ventures are financed with personal savings and funds borrowed from friends and family. Only a small percentage of new ventures use state grants and subsidized products or get funding from bank loans or credit cards. It is also important to note that a substantial percentage of start-ups (85% of businesses below 2 years of age in the UK[5], for example) do not need external financing (loan, overdraft facility) and are happy non-seekers.

In absence of a uniform definition, the analysis that follows assumes a definition of a start-up as it is understood by a specific institution, recognizing that there may be differences across them and countries. The lack of uniform definition leads to data distortion as some institutions may consider a start-up to be a business operating less than 2 years, while others, for instance in Italy and Germany the definition is based on the age criterion (up to 5 years in Italy, 10 years in Germany) as well as on additional criteria, such as innovativeness and/or technological focus.

In addition, some institution take into account other dimensions such as level of innovativeness, technology application when defining if a business is a start-up.

2.2 Microfinance in Europe and Start-ups: Overview

The European microcredit sector, as depicted by the 149 surveyed[6] MFIs from 22 countries, is diverse in terms of institutional models, although the majority are NBFIs and NGOs. Overall in 2015, surveyed institutions served 747,265 active borrowers (+13% compared to 2014), and the gross microloan portfolio outstanding reached 2.5 billion Euro (+15%).

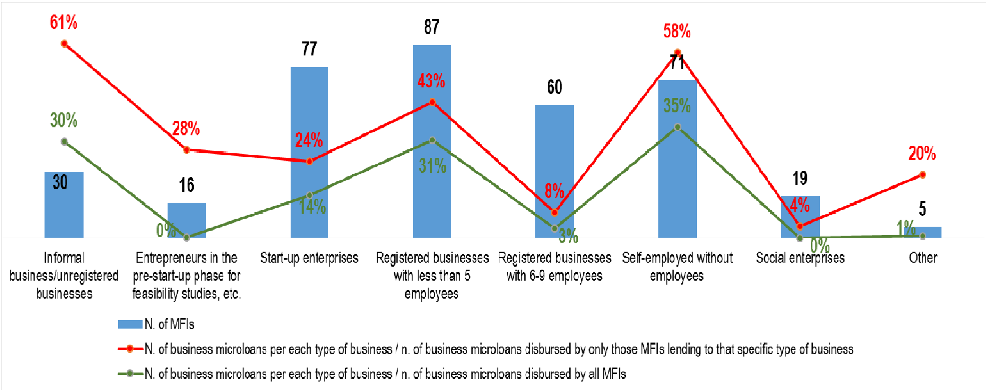
Mission statements of European MFIs primarily focus on financial inclusion and job creation goals. Consequently, as many as 77% of MFIs in the study (see Fig.2) report that they serve start-up businesses[7]. However, this segment of clients constitutes only 14% of all borrowers served by the MFIs in the study. In several countries, such as the UK and Italy start-ups constitute most clients (86% and 68%, respectively).

[5] SME Finance Monitor Q2 2016. BDRC Continental, September 2016

[6] Members of the European Microfinance Network (EMN) and the Microfinance Centre (MFC), and members of National Networks affiliated with the EMN. Full results can be found in the publication 'Microfinance in Europe: A Survey of EMN-MFC Members. Report 2014-2015'

[7] In absence of a common definition of a start-up each MFI used its own definition where reporting the number of clients.

Figure 2: Types of businesses served by MFIs



Note: 100 responding MFIs out of 124 business microlenders. Source: Microfinance in Europe: A Survey of EMN-MFC Members. Report 2014-2015.

The survey results show (see Fig. 3) that 23% of MFIs providing business loans do not work with start-ups or emerging enterprises in a pre-startup phase at all. 23% of MFIs have less than 20% of emerging and new ventures among their clients (12% of organizations have less than 10% start-ups). This shows that over half of the microfinance organizations are either not serving start-ups or do only to a small extent. Only 19% of MFIs in the survey show substantial involvement in financing start-ups with more than 80% of clients being emerging or new ventures. A little over a quarter of MFIs serve between 20% and 80% pre-and start-ups. Only 29% of microfinance institutions show pre- and start-up clients of more than 50%. There are significant differences between East and West - MFIs in Western Europe far more often had emerging and newly-established enterprises among their clients.

Figure 3: Distribution of MFIs by the share of pre-startups and start-ups clients (% of MFIs with business loans)

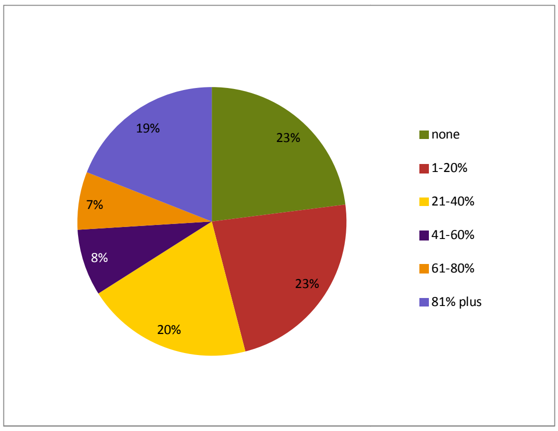
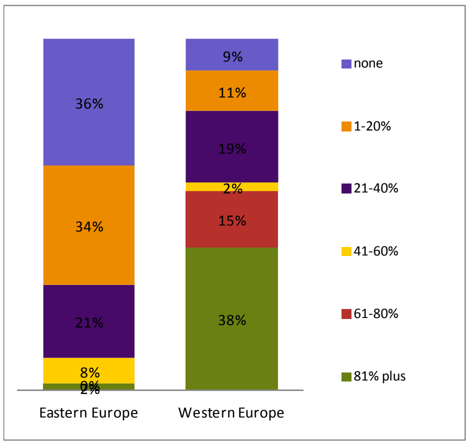


Figure 4: Distribution of MFIs by the share of pre-startups and start-ups clients and region (% of MFIs with business loans)



Source: Own calculations based on EMN-MFC Overview Survey 2014-15.

In terms of number of clients served by MFIs, only 10% serve more than 1,000 start-up clients and another 6% between 500 and 1,000 clients. On the other hand, 37% of MFIs work with less 100 clients and 23% have no start-up clients at all. Another 24% MFIs have between 100 and 500 start-ups as clients. Only 40% of MFIs have more than 100 new venture clients. On average, one in five clients is a start-up. In Western Europe more MFIs serve large numbers of start-ups: as many as 17% Western MFIs have more than 1,000 emerging or newly created enterprises among their clients.

Figure 5: Distribution of MFIs by the share of pre-startup and start-ups clients (% of MFIs with business loans)

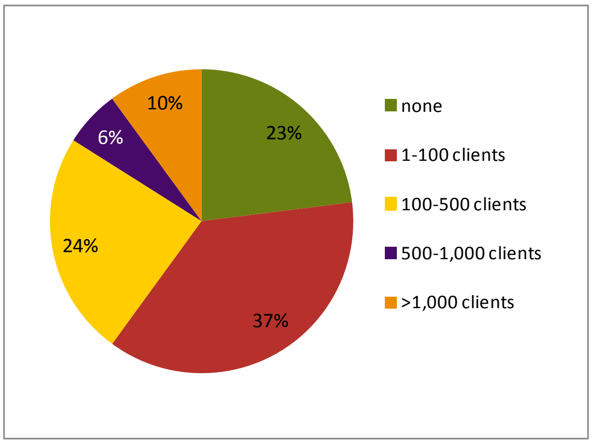
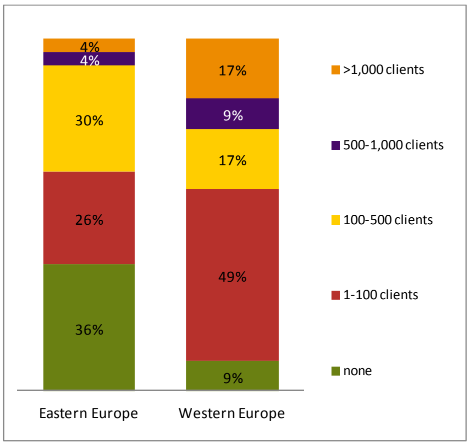


Figure 6: Distribution of MFIs by the number of pre-startup and start-ups served and region (% of MFIs with business loans)



Non-financial services emerge as a key element of microfinance provision in Europe. In fact, more than half of the MFIs surveyed (58%) follow an integrated approach allowing for the provision of financial products (primarily business and personal microloans, savings and business loans) and non-financial services. 47% of MFI which give business loans also provide BDS or entrepreneurship training. In 2015, the surveyed MFIs reached 205,943 clients with their non-financial services (principally financial education and business development services), which is 27% of all clients served and not all clients receive assistance with starting or organizing a new business[8]. In countries such as Hungary, Italy, Spain and the UK most of the MFIs which took part in the survey provided both financial and non-financial services, as opposed to Albania, Macedonia, Montenegro and Romania where most MFIs offered only financial products and services. Providing both non-financial and financial services is typical for MFIs which are driven by the job creation goal.

[8] Business services also include general financial literacy and other business skill development training and mentoring which may not be directly related to new venture creation. The data do not provide information how many of the recipients of non-financial services were start-ups and how many were mature businesses.

Figure 7: Share of MFIs by type of products and services offered

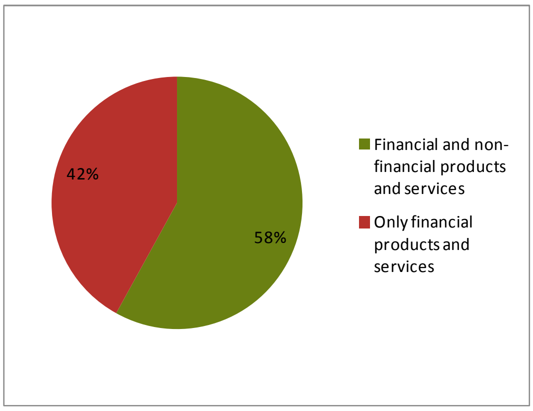
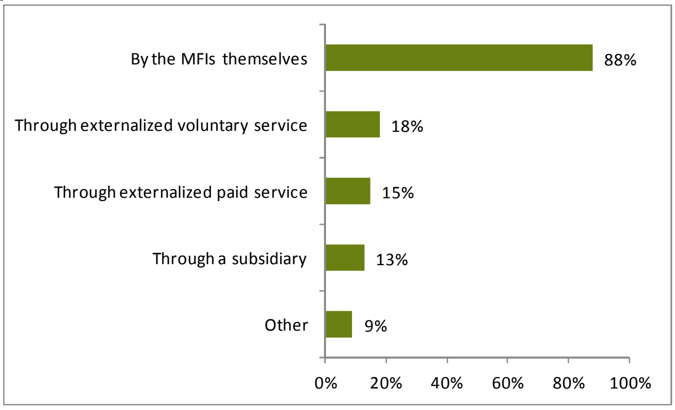


Figure 8: Share of MFIs by method to offer non-financial products and services



Source: Microfinance in Europe: A Survey of EMN-MFC Members. Report 2014-2015.

Most MFIs following the integrated approach report that they provide non-financial services themselves (see Fig. 6), but some MFI either completely outsource or externalize these services, or provide them in-house and externally.

These statistics show that MFIs work with start-up clients, but their involvement is quite varied and overall not very strong. Only a small number of microfinance institutions is fully dedicated to new venture creation and business start-ups, while the majority have limited involvement and small number of start-up clients, with about one-quarter of MFIs completely avoiding the start-up market. However, it is important to note here that that MFIs use different definitions of start-ups with many of them understanding start-ups as very early-stage enterprises. If one common definition was used, for instance up to 2 years which is often referred to, then the number of MFIs serving such understood start-ups would be higher.

3. Research Objectives and Methodology

This paper presents findings of the research project which aimed at exploring the conditions for business creation and start-up development and the role of microfinance vis-a-vis start-ups. The study focused on the national strategies supporting entrepreneurship, the role of governmental programs in supporting business creation and the overall financial and non-financial support offered to start-ups by financial institutions and other relevant actors. Country-level case studies were published detailing the situation in each country and offering recommendations for programs, products and services that would help to provide financial and non-financial services to more start-ups and to do it more effectively.
The project started in 2016 when the research was carried by Microfinance Centre (MFC) in three countries - Bulgaria, Hungary and Romania. In 2017, the project was extended on 8 additional countries and was implemented by two microfinance networks - Microfinance Centre (MFC) in Albania, Macedonia, Montenegro, Serbia, and by European Microfinance Network (EMN) in Germany, Italy, Spain and the UK.

The project was implemented within the four-year Framework Partnership Agreement of MFC and EMN with the European Commission.

The research was conducted in three stages, including desk study, interviews with key stakeholders and group discussion with the main providers of services to start-ups.
The desk study focused on identification of the national strategies and action plans as well as mapping of current initiatives offering support to entrepreneurs. During the interviews with stakeholders, we aimed at understanding the role of each of them in supporting business creation and start-up development and about the involvement of state institutions in creating enabling environment for entrepreneurship. Particular attention was given to microfinance initiatives to learn about their current engagement, limitations and opportunities in extending this support. The third stage of the project was implemented though group work of the stakeholders to elaborate ideas for improving the ecosystem for start-ups.

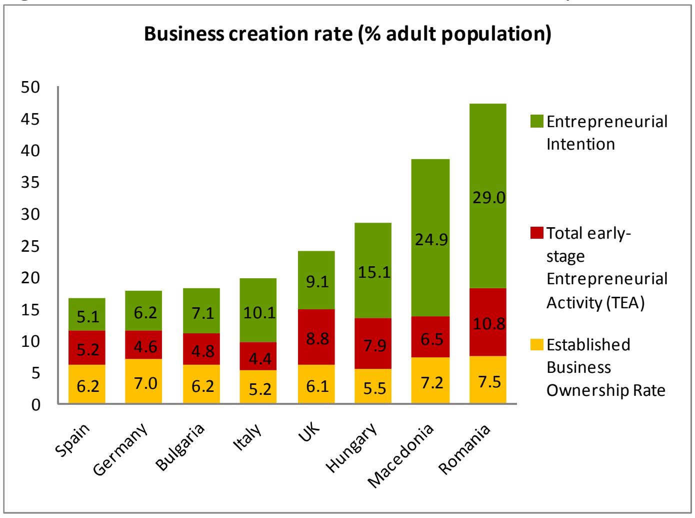
4. Entrepreneurship and Start-ups in Europe

4.1. Entrepreneurial Potential

The results of the Global Entrepreneurship Monitor (GEM)[9] surveys show that the level of enterprise creation across the countries covered by our research is fairly similar as between 5-7% of the adult population runs established businesses. However, the real differences are seen in the rate of creation of new enterprises. Total early-stage entrepreneurial activity[10] (TEA) ranges from 4% to 10%, and the differences in entrepreneurial intentions are even higher, between 5% and 29%. Romania and Macedonia lead in the early stage entrepreneurship and the intention rate; altogether, 47% of adults in Romania and 38% of adults in Macedonia is either already engaged in business or has taken steps to start an enterprise.

[9] http://www.gemconsortium.org/
[10] Total Early-stage Entrepreneurial Activity (TEA) rate measures the percentage of the adult population (18 to 64 years) that are in the process of starting or who have just started a business. This indicator measures individuals who are participating in either of the two initial processes of the entrepreneurial process: (i) Nascent entrepreneurs – those who have committed resources to starting a business, but have not paid salaries or wages for more than three months, and (ii) New business owners – those who have moved beyond the nascent stage and have paid salaries and wages for more than three months but less than 42 months.

Figure 9: Business Creation Rate as % of Adult Population



Source: GEM 2016 (not conducted in Albania, Montenegro and Serbia in 2016)

The entrepreneurial intentions are linked with the individual perception of opportunities and abilities to run a business and are enhanced by cultural norms.

The GEM data show that the perception of opportunities to open a business, self-efficacy (knowledge and skills to run a business) as well as presence of a role model (knowing other people who have opened a business) increases the intentions to engage in one's own business [11]. Similarly, cultural context such as perception in the society of entrepreneurship being a good career choice, high status of entrepreneurs in the society and media attention to entrepreneurship topics positively influence the willingness to engage in business.

Firstly, the perceptions about business and cultural norms vary from country to country. The index of individual perception to entrepreneurship[12] is the highest in Macedonia (1.2) and the lowest in Italy (0.6). In case of cultural influences the differences between the countries are somewhat smaller. The highest cultural support for entrepreneurship is seen in Romania cultural support to entrepreneurship index ([13] takes value of 2.1) and Macedonia (2.0) and the lowest in Hungary (1.48) and Spain (1.53).

[11] Fernández J., Liñán F., Santos F. J.'Cognitive Aspects of Potential Entrepreneurs in Southern and Northern Europe: An Analysis Using GEM-Data', Revista de Economía Mundial 23, 2009, 151-178

[12] Individual perception to entrepreneurship index expresses the individual's attitudes to entrepreneurship and is the sum of three variables: (1) perception of good opportunities to start a business,(2) perception of having the required skills and knowledge to start a business, and (3) knowing a person who started a business in the past 2 years. It takes values from 0 (low entrepreneurship perception) to 3 (high entrepreneurship perception)

[13] Cultural support to entrepreneurship index expresses the perception of cultural norms in the country and is the sum of three variables: (1) perception of entrepreneurship being a good career choice,(2) high status of entrepreneurs in the society, and (3) media attention to entrepreneurship topics. It takes values from 0 (no cultural support) to 3 (high cultural support)

Figure 10: Individual perception to entrepreneurship index and entrepreneurial intention

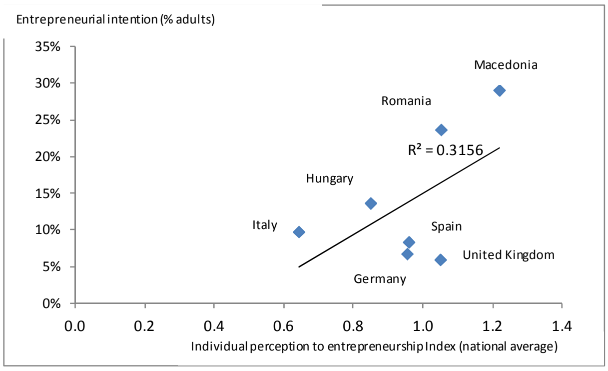
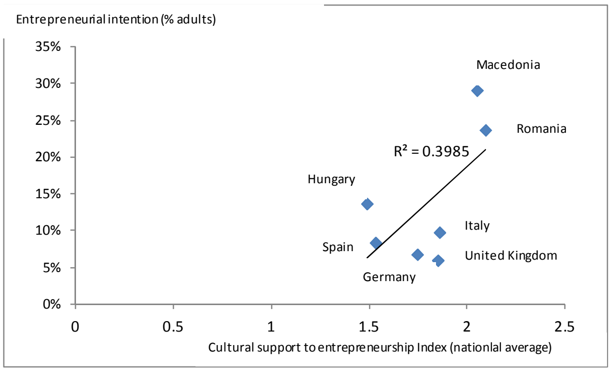


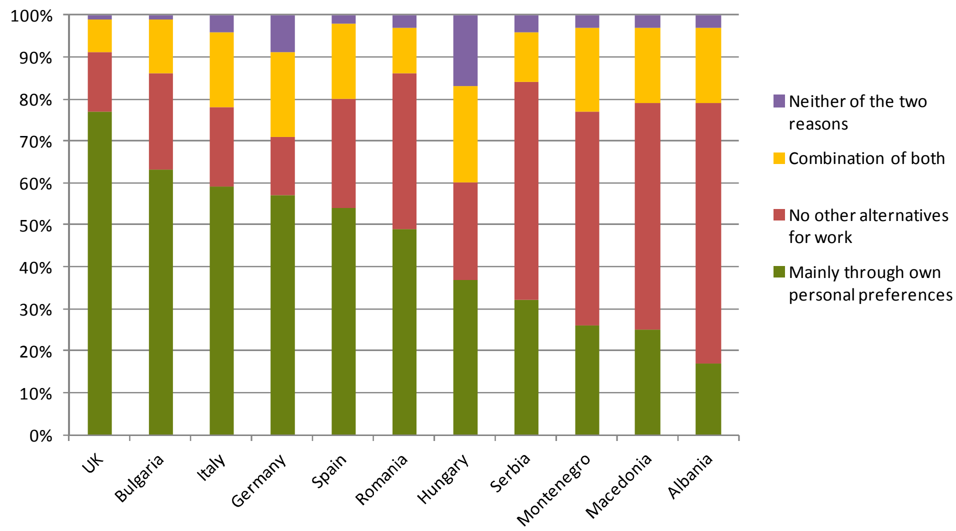
Figure 11: Cultural support to entrepreneurship index and entrepreneurial intention



Source: Own calculations based on GEM 2013 data

Another important driver of entrepreneurship is the motivation to start a business. In many countries, people are driven towards business activity by personal preference to be self-employed (the UK, Bulgaria, Italy, Germany and Spain), while in other countries, such as Albania, Macedonia, Montenegro and Serbia the most important factor is lack of other employment opportunities and the need to create one's own job to earn a living.

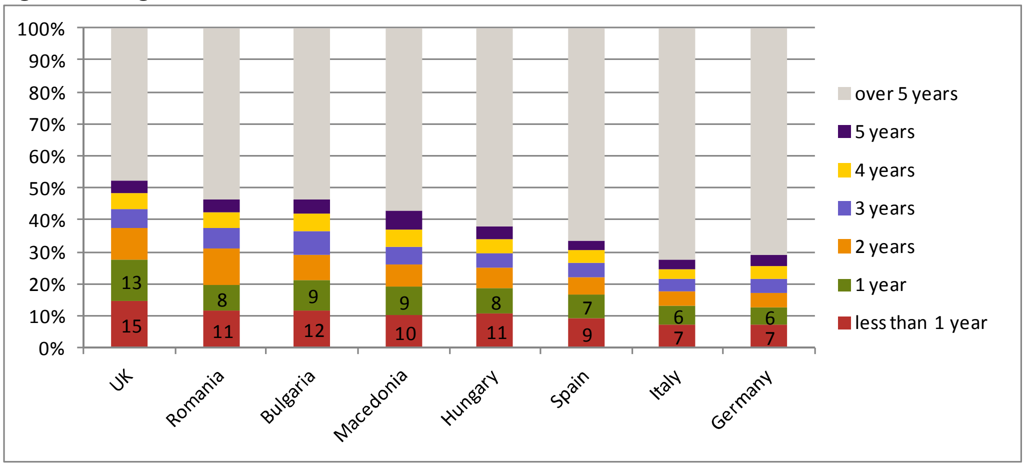
Figure 12: Motivation for Starting a Business in Select Countries in Europe



Source: European Working Conditions Survey 2015

It is important to be aware of the share of start-ups in the population of enterprises. While there is no common definition of a start-up in Europe, the most common proxy is 2 years since the company registration. According to the Eurostat statistics, the share of nascent and early-stage enterprises established less than 2 year ago in the total number of businesses in the country is considerable - between 13% in Germany and 27% in the United Kingdom. Each year alone, between 7% and 14% of new enterprises are created in the respective countries. However, the age of the majority of enterprises operating in each country is above 4 years.

Figure 13: Age Structure of Business Firms in Select EU Countries



Source: Own calculations based on Eurostat data 2016

4.2. Barriers to Entrepreneurship and Self-Employment

Entrepreneurs face many barriers at various stages of growth with the most pressing problem being finding customers. Access to finance is not among the most important problems for firms in the EU with the severity score of 4.8 on the scale from 1 to 10[14], according to the SAFE study. For young enterprises in operations for less than 2 years the order of the severity of the problems is almost the same as for the mature ones, but they find it more difficult to reach customers and access financing. Altogether, 26% of young firms find access to finance the most severe of all problems to business development, compared to 21% of the mature firms.

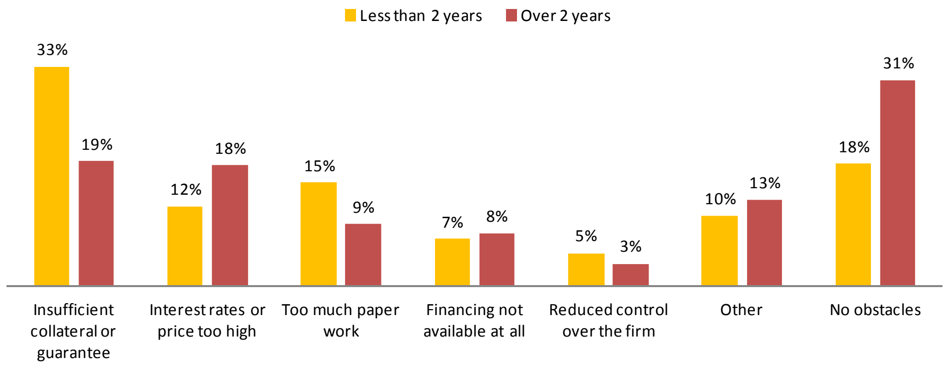
Figure 14: Severity of problems affecting young and mature SMEs

[14] The scale of measurement for the 'Pressing Problem' indicator is from 1 - the least pressing to 10 - most pressing)

Source: Own calculations based on SAFE data 2014

For young SMEs, the most limiting factor to accessing the right amount of financing for growth is lack of collateral required by the financial institution and too much bureaucracy. In case of mature firms, guarantee requirements are also the largest obstacle, followed by the price of funding. But what most distinguishes young enterprises from the mature ones is the incidence of obstacles - far more mature SMEs do not perceive any obstacles to getting required financing (31%) compared to young firms (18%).

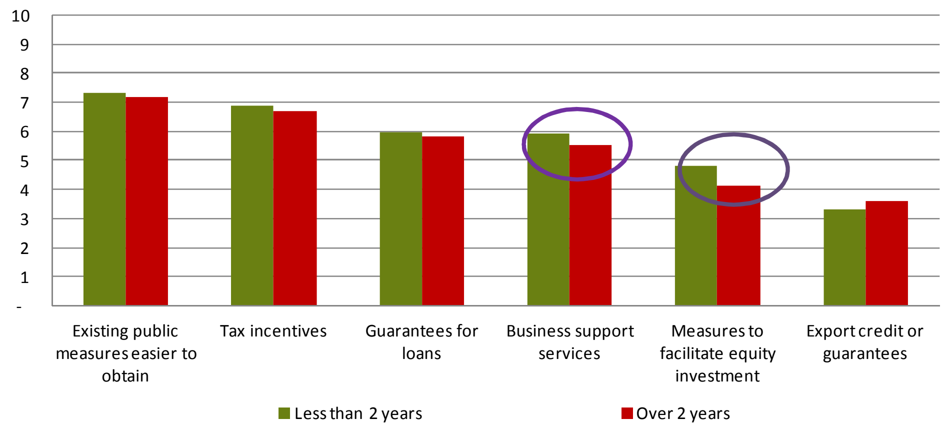
Figure 15: Factors limiting access to financing needed for growth



Source: Own calculations based on SAFE data 2014

When asked about the importance of various solutions to improve financing in the future, most enterprises pointed to the need of easing access to public measures. Also, tax incentives and guarantees were indicated as important factors. Young firms more often than mature ones mentioned business support services and measures to facilitate equity investment as important for them.

Figure 16: Factors important for enterprises financing in the future (1 - not important, 10 - most important)



Own calculations based on SAFE data 2014

There are several constraints related to the personality of the entrepreneur and the capacity to search for financing. Lack of confidence in talking with bank representatives is one of the constraints in accessing financing - young enterprises feel less confident when talking with banks, although there are no age differences in confidence with equity investors. Additionally, the fear of the rejection is the driver of not applying for loans and other types of financing, more strongly seen among young enterprises.

Figure 17: Confidence in talking with financial providers by enterprise age

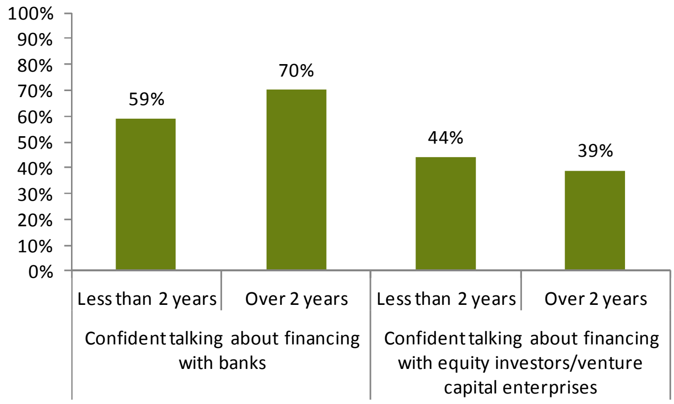
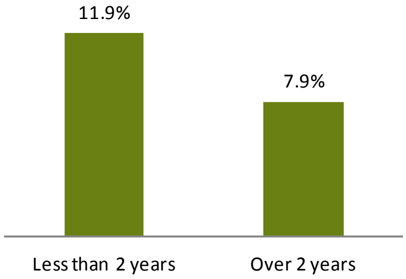


Figure 18: Incidence of not allying for financing because of the fear of rejection



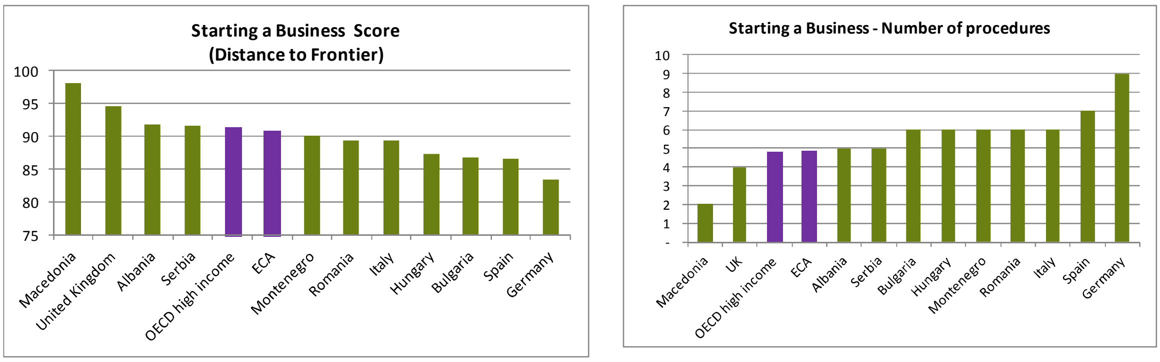
Own calculations based on SAFE data 2014

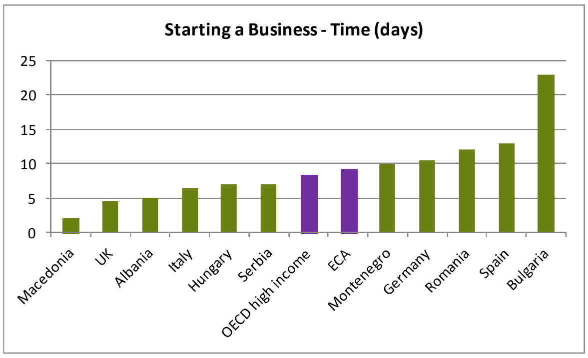
Additionally, the regulatory sphere and enabling environment to performing business operations is an important factor for the willingness to open a business. In the *Doing Business* survey of the World Bank a section 'Starting a Business' evaluates the conditions for opening a company.

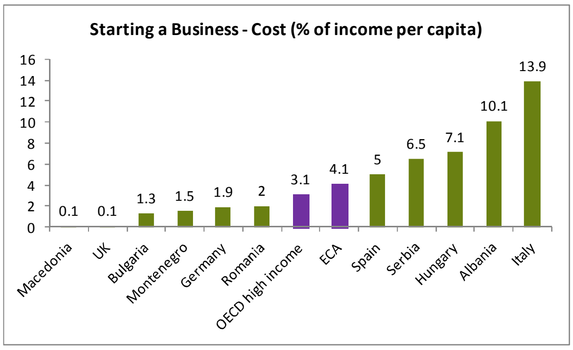
Among the countries covered in this study, two countries exceed the others in the ease of opening a business. Macedonia continues to be one of the easiest places to open a business, currently ranking 4th out of 189 economies of the World Bank's *Doing Business* - indicator. The United Kingdom follows closely, ranking 16th. Altogether, four countries - Macedonia, the UK, Albania and Serbia perform above the average for ECA and OECD high-income countries.

Germany is the most difficult country among the ones covered by this study to start a business. It is also behind many other economies, ranking 116th out of 189 economies. Starting a business in Germany is a bureaucratic process with 9 procedures to perform which altogether takes 10 days. However, the cost of the company registration in Germany is lower than the average for ECA and OECD high income countries.

Figure 19: Doing Business - Starting a Business indicators







Source: Own calculations based on World Bank's Doing Business 2016

4.3. Demand for Start-up Financing

Several research studies confirm that the demand for external financing among SMEs is not overly high. The Enterprise Surveys[15] in the Balkan countries (2013) show that many small firms (5-19 employees) do not apply for loans because of no need. In Albania, for instance, only 20% of firms use bank loans/credit lines, while 72% of firms did not apply for bank credit because they did not need it which leaves only 8% of small firms which currently do not use or apply although they need a loan. Similarly, the study conducted in the UK[16] in 2016 showed that 77% of SMEs are happy non-seekers of finance in the last 12 months. Only 2% looked for finance but were prevented from using it because of the discouragement or rejection from a bank, expensive and difficult application process. In other countries, the demand is somewhat higher. The assessment[17] carried out in Serbia in 2016 showed that while 46% of firms do not use loans because of no need, 21% of SMEs do not use for other reasons.

However, when taking enterprise age into account, it turns out that, according to SAFE 2014, more young enterprises (74% of firms below 2 years) need external financing to realize growth ambitions compared to more mature firms (57%). When planning growth, SMEs mainly count on bank loans, out of all external sources, with young firms more strongly preferring bank loans compared to mature firms.

[15] An Enterprise Survey of the World Bank is a firm-level survey of a representative sample of an economy's private sector. The surveys cover a broad range of business environment topics including access to finance, corruption, infrastructure, crime, competition, and performance measures. To date, the survey has been conducted in 139 countries. http://www.enterprisesurveys.org/

[16] 'SME Finance Monitor', BDRC Continental 2016

[17] Business Survey: Serbia 2016. USAID Business Enabling Project (BEP)

Figure 20: Preferences towards types of external funding sources (% of firms in need of external financing for growth)

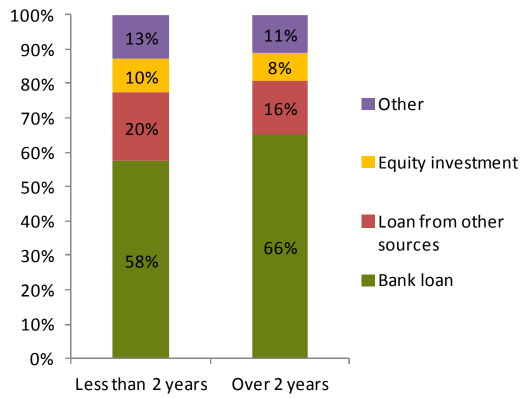
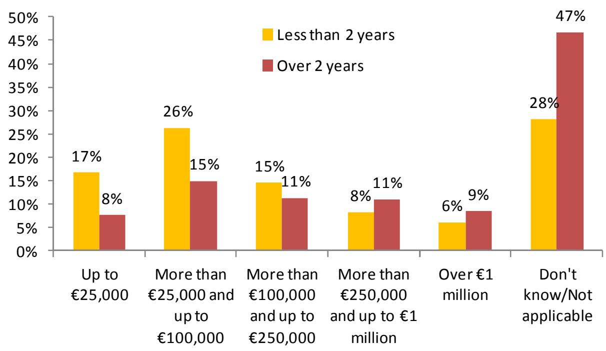


Figure 21: Funding needs of SMEs by enterprise age



Source: Own calculations based on SAFE data 2014

Young enterprises have smaller funding needs compared to mature SMEs. They most often require between 25,000 Euro and 100,000 Euro.

The most recent assessment[18] of the market potential for business microcredit in EU-28 showed for 2016 a total potential of 2.7 million loan applications from such groups as potential new business founders (1.3 million), existing solo entrepreneurs and microenterprises (1.2 million) and individual farms in Eastern Europe (0.3 million applicants).

5. Start-up Support Ecosystems in Europe

5.1. Policy Support for Entrepreneurship

Entrepreneurship and new venture creation is the cornerstone of the EU and national policies for economic growth and employment. Only 37% of Europeans would like to be self-employed, compared to 51% of people in the US and China[19]. Some of the challenges to be tackled include: education that does not offer the right foundation for an entrepreneurial career; difficult access to finance and markets; difficulty in transferring businesses; the fear of 'punitive' sanctions in case of failure; burdensome administrative procedures. Consistent with the findings from the survey presented earlier, access to finance is but one barrier to entrepreneurship, and not always the top ranking one. The EU's Entrepreneurship Action Plan 2020[20] outlines key support measures and programs to stimulate entrepreneurship at the EU level, and includes a series of measures for access to finance (under Action Pillar 2), however microfinance and small entrepreneurship is not explicitly included in these measures.

[18] ' Market perspective of business microcredit in EU-28'. Evers & Jung 2017

[19] https://ec.europa.eu/growth/smes/promoting-entrepreneurship_en

[20] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0795

All countries covered by the research actively support, to a varying degree and extent, entrepreneurship and SME development with national strategies being part of the economic development agenda (Germany[21], Serbia[22], Romania[23], Bulgaria[24] and Hungary[25]). Italy[26] has adopted measures aimed at encouraging the creation and development of innovative start-ups, and introduced into the Italian legal system the definition of a new one - innovative company, the start-up[27]. For this type of company tools and measures that affect the entire life cycle of the company have been prepared, from the start up to development and maturation (without sectoral distinctions and age-related limits for the entrepreneur). In other countries, actions aimed at boosting entrepreneurship are part of the employment strategies. The example here is Albania[28] and Spain[29]. In Montenegro[30] and Macedonia[31], the national strategies have expired and are to be renewed for the years to come.

The EU-level and national strategies (for example, Germany, Serbia, Albania, Spain) to support entrepreneurship often refer to specific target groups, including vulnerable ones, such as youth, women, ethnic minorities or social entrepreneurship. In general, employment creation is not an explicit objective of entrepreneurship and business start-up[32].

Moreover, support for entrepreneurship does not automatically imply support for self-employment, business creation, as services are provided to mature businesses for further development and entrepreneurial growth as well. Furthermore, the strategies are addressed to various groups, such as potential entrepreneurs among the young (e.g. students), the unemployed or tech firms who are not necessarily microfinance clients. . Member states aim at improving national competitiveness through supporting innovation or job creation through fast growing enterprises. In the UK, for example, business creation has faded[33] as a national policy priority in recent years, as the economy has recovered, and

[21] Germany: 2013-17

[22] Serbia: 'Strategy to Support Development of SMEs, Entrepreneurship and Competitiveness for the Period 2015–2020'

[23] Romania: 'National Strategy for SMEs and Business Environment (Horizon 2020)'

[24] Bulgaria: 'National Strategy for Small and Medium-sized Enterprises 2014-2020'

[25] Hungary: '2014-2020 Development Strategy of Small and Medium Sized Enterprises'

[26] Decree Law 179/2012, 'Further urgent measures for growth of the country'

[27] Law 221/2012 defines a start-up as a companies with shared capital (i.e. limited companies), including cooperatives, the shares or significant registered capital shares of which are not listed on a regulated market nor on a multilateral negotiation system. These companies must also meet the following requirements: (1) be new or have been operational for less than 5 years; (2) have their headquarters in Italy or in another EU country, but with at least a production site branch in Italy; (3) have a yearly turnover lower than 5 million Euros; (4) do not distribute profits; (5) produce, develop and commercialize innovative goods or services of high technological value; (6) are not the result of a merger, split-up or selling-off of a company or branch; (7) be of innovative character, which can be identified by at least one of the following criteria: (i) at least 15% of the company's expenses can be attributed to R&D activities; (ii) at least 1/3 of the total workforce are PhD students, the holders of a PhD or researchers; alternatively, 2/3 of the total workforce must hold a Master's degree; (iii) the enterprise is the holder, depositary or licensee of a registered patent (industrial property) or the owner of a program for original registered computers.

[28] Albania: 'National Employment and Skills Strategy (2014-2020)'

[29] Spain: 'Strategy for Entrepreneurship and Youth Employment 2013-16' renewed until 2020

[30] Montenegro: National Strategy for Development of Small and Medium Enterprises 2011-2015

[31] Macedonia: National Development Strategy for SMEs 2011-2013

[32] FinTech for micro, small and medium sized enterprises – creating jobs at the bottom of the pyramid through financial and digital inclusion' ING Economics Department, 2016

[33] Research shows that some countries may have too many small businesses. In the US, only 11 percent of employed Americans work at firms with fewer than 10 employees while 58 percent of Greeks do. Overheating of startups in Ireland and neglect for support for larger enterprises contributed to the economic crisis.

employment is at pre-recession levels. The vision for an industrial strategy presented in a green paper in January 2017 focuses on scaling up of start-ups in STEM industries (science, technology, engineering and mathematics) and in digital. In short, while the national policies continue to promote entrepreneurship in general, the precise nature and scope of this support varies based substantially among the member states.

5.2. Review of Select Start-up Ecosystems in Europe

The ecosystems for start-up support are composed of a variety of institutions, ranging from state institutions such as development agencies, employment bureaus, to private companies commercially-oriented and non-profit institutions. They provide a variety of financial and non-financial services.

There are two main sources of funds for start-up support: public and private - with public sources either originating from the national resources or from EU programs. Rarely, but also used are the public funds from non-European countries (USAID) or from specific country-to-country allocations (e.g. KfW, FMO funds for other countries).

State institutions include employment bureaus and job centers, development agencies, often with local offices in the regions, as well as innovation or development funds. State institutions implement start-up support programs in almost every country under review. They use national funding as well as funds from the EU or the World Bank.

Start-up support services are also extended by commercial companies, such as commercial banks, and non-profit foundations or not-for-profit MFIs.

Only a few commercial banks were found to provide services to start-ups. These include Erste Bank which runs a special program 'Step by Step' within which a package of financial and non-financial services is extended to starting entrepreneurs. The program is active in all countries of Erste Bank's operations. In Germany, development banks (Förderbanken) are special banks with a governmental mandate that provide credits, investments, mezzanine capital or guarantees. Development banks work through intermediaries - all credit applications and credit contracts with DBs are handled by a principal bank of the client.

Only in several countries microfinance institutions use public funds. The examples include Germany and the United Kingdom. In Germany, MFIs use funds of a microcredit fund MKF Deutschland set up by the Federal Ministry of Labor and Social Affairs (BMAS) and the Federal Ministry of Economics and Technology (BMWi) which utilizes federal budget funds and resources from the European Social Fund. In the UK, the state program Start Up Loans Company (SULCO) is delivered through microfinance institutions.

A number of MFIs uses their internal funds to provide access to finance for start-ups. The majority of such institutions in South-East Europe use only their internal funding to extend services to start-ups.

---

http://www.slate.com/articles/business/small_business/2012/07/the_small_business_problem_why_greece_italy_and_spain_have_too_many_small_firms_.html

Table 2: Start-up Ecosystem participants by type of institution, funding source and services provided

Source of funds/ Implementor	State institution	Commercial company	Non-profit institution
Public (national, EU)	**Mixed programs:** AIDA (Albania) FITD (Macedonia) Employment bureau (Montenegro) AIPPIMM (Romania) Employment office, RAS (Serbia)	**Mixed programs:**	**Mixed programs:** UNDP (Albania) MFIs accredited by DMI (Germany) Local Enterprise agencies LEA (Hungary) MFIs (Italy) CEED (Macedonia) SULCO program implemented by MFIs (UK)
	Financing only: Job centers (Germany) Fund for Development, Innovation Fund (Serbia) Employment Agency, (Macedonia) IDF (Montenegro) Invitalia (Italy) DAPIMM (Romania) Institutos de Finanzas, Seed Capital Bizkaia, SODEBUR (Spain)	**Financing only:** Commercial banks (Germany) CKB (Montenegro)	**Financing only:** JOBS MFI (Bulgaria) SULCO program implemented by MFIs (UK)
	BDS only: Business development agencies, IHK (Germany) APPRM (Macedonia) DDSME (Montenegro) AIPPIMM (Romania) Regional entrepreneurship centres, CEEIs (Spain)	**BDS only:**	**BDS only:** Business incubators (Albania, Macedonia, Montenegro, Serbia, UK) SEED Foundation (Hungary) CNA (Italy) Youth Business Serbia, Spain Autoocupacio, INCYDE Foundation (Spain)
Private	**Mixed programs:**	**Mixed programs:** Erste Bank (Hungary, Montenegro, Romania, Serbia)	**Mixed programs:** Kiutprogram (Hungary)
	Financing only:	**Financing only:** OBS (Serbia) Hipotekarna Bank (Montenegro)	**Financing only:** MFIs in (Albania, Bulgaria Macedonia, Montenegro, Romania, Serbia, Spain, UK)
	BDS only:	**BDS only:**	**BDS only:**

There are two main groups of services extended to start-ups: financial services such as grants, loans, capital investments, guarantees, and non-financial services such as training, mentoring, consulting on topics related to business creation and development. Many institutions provide a mix of financial and non-financial services.

5.2.1. Financial services

Small grants are a typical form of support extended by employment bureaus or state-run development agencies. Grants of a few thousand Euro, often requiring co-financing from the entrepreneur, are provided for purchasing equipment or for covering general expenses associated with setting up a company. In some countries, such as Germany grants for paying social contributions in the first year of business operation are provided to the unemployed together with the equivalent of six-month unemployment benefit.

Loans are the most popular form of financial support for business creation and are extended by all types of institution, including state agencies and investment funds (Montenegro, Spain), commercial banks and microfinance institutions in all countries under review.

Equity financing is not widely offered for start-ups in non-tech industries. However, there is an example of Seed Capital Bizkaia in Spain, a company attached to the Department for Economic and Territorial Development of the Provincial Council of Bizkaia which provides equity, venture capital, and loans to new companies or existing SMEs which promote social innovation. Also, some business incubators have investment facilities (CEED Macedonia).

5.2.2. Business support services

Business support services typically range from information sharing to training and mentoring on how to prepare a business plan, how to do the accounting and manage finance, how to market the products, manage human resources, etc. They are often provided in combination with financial services (mixed model). For instance a training on business creation is often a pre-requisite to receiving a grant or loan on favourable terms, or mentoring and consulting services are available throughout the duration of a loan. A good example of a combination of financial and non-financial services are Italian MFIs which are mandated by the regulator to provide business support to their clients. Non-financial services can be provided by the same institution offering financial products, or can be externalized to a specialized provider of non-financial services.

Finally, there are institutions which provide only non-financial services to aspiring entrepreneurs and start-up businesses. The notable example are business centres and incubators which in many countries offer office space, administrative support, mentoring, coaching and link their tenants with investors or help in applying for grant or loan funding.

In several countries, such as Serbia, Spain, Romania development agencies through local offices or accredited regional units deliver programs aimed at developing entrepreneurial skills and often facilitate access to finance. Chambers of Commerce are also active in several countries. In Spain, the Chamber of Commerce created the INCYDE Foundation dedicated to foster entrepreneurial spirit through trainings, advisory services and business incubation centres. In Germany, the Chamber of Industry and Commerce (IHK) cooperates with development banks to attract borrowers and provide basic business consulting and training services. It also facilitates access to the grant program for consulting services offered within the 'Encouragement of entrepreneurial know-how' project.

6. Microfinance and the Entrepreneurial Ecosystem: Discussion

There is a large diversity among the countries covered by the study (and in the EU in general) as to the place of microfinance institutions in the ecosystem for start-ups. There are also numerous barriers and challenges that MFIs face in the start-up economy market, some of which relate directly to the very nature of risk involved in a start-up business, and others to the limitations of services that MFIs can offer to new entrepreneurs and the overall entrepreneurial environment in the country.

6.1 Role of Microfinance Institutions in the Start-up Economy

The role of microfinance and MFIs is defined by several factors which include the ability of MFIs to assess and accept the start-up risks, the prevailing type of entrepreneurial activities in the economy, and the overall supply of start-up capital in each country. There are also constraints on the demand side. A significant percentage of business start-ups using their own resources (or those of friends and family), and many others use bootstrap techniques to fund their businesses[34], leaving microfinance and other lenders and investors with only a portion of the start-ups seeking funding.

The scale of involvement of microfinance institutions to support start-ups in small. For example, MFIs' reach in France, which is one of the highest in Europe, does not exceed 3% of all start-ups[35], although this percentage is higher if we consider only the business start-ups that actively seek funding on the market[36]. This shows the potential scale of reach that can be achieved by microfinance. In addition, not all types of entrepreneurial projects are eligible or suitable for MFIs either because the nature of the projects (e.g., high-tech innovations) in which MFIs do not have expertise, or the amount of financing that they can offer.

Finally, it must be noted that as a financial institution an MFI has limited scope to actively foster the number of start-ups, and only can provide limited entrepreneurial support for new businesses[37]. Some MFIs, especially in the Western Europe, where more public funding is available, offer some support and wraparound services for businesses, including start-ups, but by doing this they increase the costs and complexity of operations while targeting only a small number of potential and actual start-ups. Increasingly, MFIs spin-off or outsource the business support services to focus on the financial

[34] https://techcrunch.com/2017/07/01/invisible-unicorns-35-big-companies-that-started-with-little-or-no-money/ - the startup capital of the businesses mentioned in the paper could be easily funded by a microfinance institution as in many cases the initial amounts did not exceed $10,000.

[35] Own calculations from data collected through EMN-MFc Overview Survey 2014-15. In the survey, each MFI used its own definition of a start-up.

[36] There are no already available data on how many enterprises are looking actively for funding during the start-up phase

[37] The nature of MFIs involvement in entrepreneurship and business support in Europe differs from how microfinance institutions operate outside of Europe where they mostly act as financial institutions. MFIs that provide business services in Europe increasing separate out such activities from their lending operations, as has been demonstrated by PerMicro and Qredits.

transactions, and to make their operations more sustainable. Still, the services are quite limited and not likely to cater to all the needs of a start-up entrepreneur. Scaling up would require additional public funding sources.

Reviewing the current state of involvement of MFIs in funding the new ventures, four clusters of microfinance institutions emerge:

- MFIs with sole or predominant focus on business start-ups: such organizations are created with the mission of supporting start-up enterprises, for example Youth Enterprise Scotland or Seed Capital Bizkaia Micro. This category comprises MFIs for which at least 80% of their portfolios is composed of new ventures.

- MFIs with a mix of start-up and operating business clients: such MFIs offer loans to start-ups as well as existing businesses, and potentially offering other services such as personal loans, factoring, and others, and have a varying share of start-ups in their portfolios. This category includes the majority of MFIs in Western Europe and some MFIs in Eastern Europe such as, for example, Mikrofond in Bulgaria. The portfolios comprise up to 80% of new ventures.
  In this group of MFIs there are institutions which treat a start-up or an early stage business as any other existing business, and does not separate it out for risk management purposes. This partly driven by the lack of clear definition of a start-up, the nature of the business start-up (start-ups that immediately generate cash), and the overall approach of an MFI to providing financing to businesses (i.e., all viable businesses regardless of age and business maturity).

- MFIs with ad hoc or special projects for business start-ups: these organizations offer start-up financing on a limited scale, using special projects (such as EaSI guarantee fund) or opportunistically when a good project is presented for funding. Examples include organizations such as Besa Fund in Albania. The share of new venture projects for this category of MFIs does not exceed 20% of the overall portfolio.

- MFIs which do not serve start-ups either because they cannot do it because of regulation (for example, credit unions which can only provide personal loans), as a strategic choice for market positioning, or for other reasons such as prohibition by investors or fear of regulatory repercussions related to potential high losses on the start-up market.

It is interesting to note that most MFIs in the countries included in this study declare willingness to serve the start-up market, however the ability and readiness to be engaged greatly varies. The majority of MFIs shy away from this market citing numerous challenges and barriers to profitably and effectively work with start-up ventures.

6.2 Challenges to MFI Involvement in the Entrepreneurial Ecosystem

Microfinance institutions encounter many common obstacles in addition to country-specific challenges:

1. Lack of clarity what is considered a start-up

   There are MFIs which consider all their clients to be start-ups. Since there is no common definition of a 'start-up' they view all microenterprise clients to be at the early stage of growth because of the often-changing nature of the business, high business failure rate and weak cash flows. Other MFIs do not classify their clients as start-ups even though many of their borrowers are in the early stages of business development or re-start their businesses in a modified form. Lack of common definition prevents from understanding the actual level of involvement of microfinance in start-up support.

2. Access to funds for on-lending to start-up enterprises

   While dedicated state funds are committed to start-up support in every country, usually the programs are implemented by state institutions and the microfinance sector rarely has access to these funds. A notable example is the UK system, where MFIs are the implementers of the government-funded program (SULCO[38]). Also, in Germany MFIs disburse loans from the state-managed microcredit fund MKF Deutschland.

   In other countries, MFIs rely only on private funds to finance start-up loan portfolio, as the direct access to the EU funds is limited to large institutions. Banks are predominant recipients of the funding within the EaSI program with only 18 MFIs (out of about 400 MFIs operating in Europe[39]) having access to the EU funds. MFIs using their own resources to finance start-up enterprises are more often seen in the South-Eastern countries where there is clear separation between state and private support: state funds are used by state institutions while private FSPs can only use own resources or the EU funds, such as EaSI.

3. Sustainability of MFIs

   This is a particularly pressing issue in the countries of South-Eastern Europe where microfinance institutions operate on a self-sustainable basis. Using commercially-priced investor funds adds to the already high costs of serving start-ups which for social reasons should not be transferred to the client.

4. Products and services

[38] SULCO - Start-up Loans Company is a state program in the UK delivered through microfinance institutions.

[39] Overview of the Microcredit Sector in the European Union. EMN 2012

While microfinance institutions in all countries serve start-ups to some extent, with several MFIs focusing only on start-ups, none of them have specific products that address the needs of start-ups that are different from those of more mature firms. The traditional cash flow product of a microfinance institution does not fit the needs of a pre-start-up and early-stage firm which still needs to prove the viability of its product concept. The immediate repayment requirement even with a grace period (which are typically short, i.e., 3 months) does not match the capacity to generate cash for running the new business and repay the loan. MFIs do not have a start-up finance product, even those that are fully committed to start-up market.

5. Capacity

MFIs lack the capacity to serve entrepreneurs in the pre-startup phase and in the early stages of operation before achieving positive cash flow. Institutions, especially in Eastern Europe avoid serving businesses younger than 6 months because loan officers have no skills to assess the business plan and the chances of success of the business. In case of businesses with no credit history and short business track record it is difficult for them to assess risk and make a loan decision.

6. Non-financial services

The roles differ from country to country. While in several countries (Germany, Hungary, Italy) MFIs engage in providing both financial and non-financial services to start-ups, in the majority of countries they focus on loan provision because there are no subsidies to support it available at country level and the EU, especially in Eastern European countries. The EU's central fund, such as EaSI does not provide it assuming that this is the role of ESF in each country. Providing non-financial services is not always in line with the mission or the business operations of the MFI. Even if subsidies were provided, not all MFIs would be willing to provide non-financial services, at least not directly as it has been considered a bad practice to bundle financial and non-financial products.

7. Legal and regulatory sphere

At the national level, there are regulatory obstacles in some countries to the development of microfinance in several countries. The examples include Serbia, Spain and Italy. In Serbia, the law restricts credit provision only to banking institutions and MFIs have to partner with banks, which extends the disbursement process and increases the cost of credit delivery. In Spain, there is no regulatory framework for governing microfinance which is a barrier to sector development. In Italy, the law restricts provision of microcredit to microentrepreneurs whose annual revenues do not exceed 200,000 Euro. In comparison, the European Commission defines microeneterprise as an entity with the maximum revenue of 2 million Euro, therefore Italian MFIs can only serve a sub-segment of the smallest microenterprises.

The current situation in the start-up financing by microfinance institutions illustrates that there are numerous challenges on various levels: micro level related to MFIs willingness and ability to serve the start-up market (especially early-stage enterprises with negative cash flow), mezzo level related to the effectiveness of the start-up support in a country, and macro level related to the national policies for supporting entrepreneurship, including new venture creation. The EU level policies also have a role to play. The Entrepreneurship Action Plan offers several actions, also in access to finance but explicit and specific role for microfinance could pave the way to greater engagement of MFIs, if not in all, in certain segments of the start-up economy where microfinance has competitive advantage over other service providers. Such competitive advantages include MFI's ability to maintain a close and personal relationship with a client, which is critical for the start-up project, ability to assess risks directly by interacting with the business owner beyond a credit score and the analysis of a business plan, ability to take higher risk unacceptable for the banks, ability to provide small amounts which are not profitable for other lenders, and ability to collaborate with other elements of the start-up ecosystem such as business advisory services, employment offices, incubators and business angels.

7. Conclusions

In each country the ecosystem for start-up support exists and includes a range of institutions, public and private, driven by social and commercial goals. Microfinance is a part of the ecosystem providing access to finance and building business skills but its role in most cases is limited. Moreover, MFIs encounter many common obstacles in addition to country-specific challenges.

7.1 Summary of the Research Findings

The limited field research supported by desk review lead to several conclusions regarding the role of microfinance in the start-up ecosystem and ways how this role could be enhanced and strengthened to better position microfinance in the start-up ecosystems.

National policies for supporting entrepreneurship exist in most of the countries, business environment is supportive, although there are issues in every country which need to be addressed, mainly related to fiscal incentives such as taxes and social contributions. To encourage entrepreneurs to set up businesses it is necessary to create conditions for successful market entry and survival. It is important to create enabling legal environment for nascent businesses, such as ease of business registration and licensing, affordable and fact ability to register collateral for borrowing, improve bankruptcy conditions, and the like. However, it must be also recognized that each country has different priorities for entrepreneurship, and not all countries will place an equal weight on new venture creation, and will target different types of ventures. Therefore, while the EU-wide guidance is important, national policies for entrepreneurship need to be considered first when determining the appropriate role for microfinance in the start-up economy. However, whether start-ups are a priority or not, there is always a need for new venture financing, and there is always a role of MFIs to play.

The national ecosystems for start-ups offer services for new firms and self-employed through state institutions with financial and non-financial programs, and MFIs. Commercial institutions are not actively involved unless they have access to public funds (national or EU). Microfinance is a part of these ecosystems, but its role is not fully acknowledged by most national policies (and the EU Action Plan), and the opportunities that MFIs could bring to the start-up ecosystem are not fully explored and exploited.

In summary, the current role of microfinance in the start-up ecosystem is limited and not fully recognized neither on the policy nor on the operational levels.

7.2 Options for Strengthening MFIs Role in Start-up Ecosystem

There are several options for expanding and strengthening the role of microfinance in the start-up ecosystem to finance new ventures (see Table 3). MFIs can play a direct and indirect role (in cooperation with other institutions) to support starts up. Some of the activities could be initiated immediately without any additional resources while others can be introduced with some or substantial operational and policy support for MFIs.

Table 3: Potential Actions for Expanding the Role of MFIs in Start-up Economy

MFI Actions	Direct Role	Indirect Role
Immediately	Financing for lifestyle start-ups and self-employed people as part of the flexible (Uber-like) labor force arrangements	Partnership arrangements with P2P platforms for financing and co-financing of start-ups
With some additional support for MFIs	Financing for small businesses, especially the typical service businesses that do not require specialized expertise on the part of MFI	
With substantial support for MFIs	Grant seed financing for pre-start-ups and start-ups channeled through MFIs and supplemented by loans as needed. Funding to expand micro- and small businesses in the early growth stage. Financing for social enterprises Financing (grants and loans) of migrant and ethnic entrepreneurial start-ups or other vulnerable groups	
Other		Agent for specialized start-up funds / incubators / government programs

The specific actions that could facilitate a greater role for MFIs in the start-up marketplace include the following:

- Definition of a ‘start-up’. A mutual understanding of a start-up, however imperfect and imprecise, will likely bring some clarity for MFIs and policy makers. Since a start-up is a staged process from ideation to launching the business to making the first sale to expanding and growing, when successful, it may be helpful to define ‘start-ups’ according to the stages, with 'start-up I' being the ideation phase, 'start-up II' - validation, 'start-up III' - launch of the business from the operational and legal point of view, 'start-up IV' – making a sale to first customer and getting cash. Beyond that, the business goes into the growth stage[40], where revenues and customers are increasing with many new opportunities and issues. Profits are strong, but competition is surfacing. Defining a start-up by its business milestones is flexible and allows accommodating distinct types of start-ups with their varying time to market and time to cash (and not only by a fixed time line, i.e., 6 months). Unless MFIs provide comprehensive business and entrepreneurship support services, MFIs may play a role for start-up III and IV.

- Access to funding for on-lending to start-up enterprises. Microfinance institutions would largely benefit from access to public funds (state or EU). This would allow them to reach more clients but also to deliver financial services to start-ups at an affordable price. Since serving start-ups is more labour intensive, MFIs need access to low-cost or free capital or one that would allow them to cover the operating costs without increasing the product pricing. Enabling access to cheaper funding would increase outreach to enterprises in early stages of operations.

- Risk support. Currently, in most of the countries, especially in South-Eastern Europe, there are no guarantee funds that could secure MFI loans to start-ups which are more risky to serve because of high failure rates. The EIF EaSI guarantee fund is a good example of such an instrument but is available only to large institutions. Lowering entry barriers would allow small MFIs to use it and thus cover the losses from default clients. Alternatively, a national guarantee fund where entrepreneurs can get a guarantee that is aligned with the risk management strategy of the MFI would allow entrepreneurs lacking collateral to use microfinance products.

- Financial products to better match the needs of start-ups. The appropriate products and services should take into account the nature of the start-up and the inability in many cases for new businesses to meet the cash repayment schedule during the early stage of development. This could include developing a hybrid product that combines features of a cash flow loan and equity features. Most of business failures in early stages are driven by lack of cash flow[41]. MFIs could develop financial products that would address the needs of the new and emergent businesses.

[40] https://www.thebalance.com/find-your-business-life-cycle-2951237
[41] http://www.businessinsider.com/why-small-businesses-fail-infographic-2017-8?IR=T

– Know-how on assessing risk. Microfinance institutions lack tools to assess the risks of new ventures in absence of risk tools, credit history of the clients, and weak capacity to conduct in-depth assessments and monitoring. At present, such tools either do not exist or are not tested with the start-up segment. Microfinance stakeholders (networks, think tanks) should engage in developing alternative scoring models. In addition, action research could facilitate learning how to better work with start-up businesses.

– Business support services for start-ups. Financial support to start-ups should go in hand with non-financial services, to equip entrepreneurs with skills to be successful in business. In particular, building skills in finding and attracting customers would kept new ventures to better address the biggest challenge in business development. Best practices of microfinance institutions which successfully provide a mix of services should be documented and disseminated among interested MFIs, including the operational aspects such as forming partnerships with external BDS providers. Locally, partners who already provide entrepreneurship education and sources of finance should be identified.

The above proposed actions are preliminary recommendations which require further elaboration in terms of operational and policy level programs. Going forward, it is also critical that the start-up economy and financing of new ventures is monitored on a regular and systematic basis through EU-wide surveys and field research. One option to consider is to partner with the Startup Genome Project (https://startupgenome.com) which attempts to track start-ups globally. Another idea could be creating and monitoring an index of entrepreneurial activity together with microfinance involvement in this area, which could be modeled after the Kauffman Index of Entrepreneurship (http://www.kauffman.org/kauffman-index). Such research supported with GEM national surveys and other data could help the EU institutions better understand the start-up ecosystem, and better define the role of microfinance and other support structures in new venture creation.

Bibliography

Business Survey: Serbia 2016. USAID Business Enabling Project (BEP)

Exploring self-employment in the European Union. Research Report. Eurofound 2017

Fernández J., Liñán F., Santos F. J.'Cognitive Aspects of Potential Entrepreneurs in Southern and Northern Europe: An Analysis Using GEM-Data', Revista de Economía Mundial 23, 2009, 151-178

Global Entrepreneurship Monitor (GEM). Global Report 2016/17

Market perspective of business microcredit in EU-28. Evers & Jung 2017

Microfinance and Start-ups in the EU. German country profile, DMI 2017

Microfinance and Start-ups in the EU. Italian country profile, RITMI 2017

Microfinance and Start-ups in the EU. Spanish country profile, AEM 2017

Microfinance and Start-ups in the EU. UK country profile, Responsible Finance 2017

Microfinance in Europe: A Survey of EMN-MFC members, December 2016

Overview of the Microcredit Sector in the European Union. EMN 2012

SME Finance Monitor, BDRC Continental 2016

Supporting 'Generation Start-up: Opportunities for Albanian MFIs. MFC 2017

Supporting 'Generation Start-up: Opportunities for Bulgaria. MFC 2017

Supporting 'Generation Start-up: Opportunities for Hungarian MFIs. MFC 2017

Supporting 'Generation Start-up: Opportunities for Macedonia. MFC 2017

Supporting 'Generation Start-up: Opportunities for Montenegro. MFC 2017

Supporting 'Generation Start-up: Opportunities for Romanian MFIs. MFC 2017

Supporting 'Generation Start-up: Opportunities for Serbia. MFC 2017

Survey on the Access to Finance of Enterprises in the euro area. ECB, May 2017

The Global Entrepreneurship Index 2017. The Global Entrepreneurship and Development Institute, 2017

This publication has received financial support from the European Union Programme for Employment and Social Innovation "EaSI" (2014-2020). For further information please consult: http://ec.europa.eu/social/easi. The information contained in this publication does not necessarily reflect the position or opinion of the European Commission.

Annex 1 - Start-up Definitions in Europe

Where used, by whom	Definition
Germany - Deutsche Startup Monitor	Younger than 10 years which is based on innovative technology or the business model embraces significant staff or profit growth
Germany - Chamber of Commerce Berlin	Innovative, young and showing high growth potential.
Germany - KfW	Digital, innovative, capital-intensive
Germany - microfinance (informal definition)	Young enterprise (not necessarily innovative or high-growth)
Italy - national definition (Law 221/2012)	Companies with shared capital (i.e. limited companies), including cooperatives, the shares or significant registered capital shares of which are not listed on a regulated market nor on a multilateral negotiation system. These companies must also meet the following requirements: (1) be new or have been operational for less than 5 years; (2) have their headquarters in Italy or in another EU country, but with at least a production site branch in Italy; (3) have a yearly turnover lower than 5 million Euros; (4) do not distribute profits; (5) produce, develop and commercialize innovative goods or services of high technological value; (6) are not the result of a merger, split-up or selling-off of a company or branch; (7) be of innovative character, which can be identified by at least one of the following criteria: (i) at least 15% of the company's expenses can be attributed to R&D activities; (ii) at least 1/3 of the total workforce are PhD students, the holders of a PhD or researchers; alternatively, 2/3 of the total workforce must hold a Master's degree; (iii) the enterprise is the holder, depositary or licensee of a registered patent (industrial property) or the owner of a program for original registered computers.
Macedonia - FITD	Up to 6 years, innovative
UK - SULCO and British Business Bank	Business that has been trading for less than 24 months
Albania, Montenegro, State institutions	Less than 2 years old
Serbia - state institutions	Less than 2 years old Less than 3 years old
All countries - informal definition used by banks	Less than 1 year old Less than 2 years old
All countries - informal definition used by MFIs	Less than 6 months old Less than 1 year old Less than 2 years old
Global Entrepreneurship Monitor (GEM)	Nascent entrepreneurs – those who have committed resources to starting a business, but have not paid salaries or wages for more than three months New business owners – those who have moved beyond the nascent stage and have paid salaries and wages for more than three months but less than 42 months. Total early-stage entrepreneurial activity (TEA) rate - % of adults being nascent

	entrepreneurs or new business owners