MFI efficiency and State intervention – what correlation?

(Empirical analysis of the two main strategic French microcredit models - used in this paper as analytical grids for the ongoing debates about microfinance in the South)

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“Microfinance is sustainable: Dozen of institutions have proved that financial services for poor people can cover their full cost, through adequate interest spreads, relentless focus on efficiency, and aggressive enforcement of repayment”

Littlefield Elizabeth and Rosenberg Richard, CGAP, (2004), «Microfinance and the Poor: Breaking Down the walls between Microfinance and the Formal Financial System », Finance & Development 41; no. 2, June; 38-40.

“MFIs that focus on financial self-suficiency bear the burden of proving that they are truly reaching the very poor. If not, then they are pushing the microfinance industry to abandon its value-based roots, and concern for the poor, however earnest, can be become simply an excuse to make a buck.”

Gary M.Woller, Christopher Dunford et Woodworth Warner, “Where to Microfinance ?”, International Journal of Economic Development, Vol. 1, No. 1, 1999, p. 26-27.

1. Neither a model nor a comparison

The purpose of this paper is to describe the two very different models of microfinance (MF) that are developing in France; and subsequently to try to underline common questions with the current debates regarding MF in Southern countries.

The comparisons with Southern MF are impossible, because the local conditions are profoundly different. However the questions about efficiency and the links between public intervention and the social impact of MF are relevant.

In France, two main networks, Adie and France Initiative, provide more than 25,000 micro loans a year to people, in majority unemployed, who want to set up a new business. These figures represent more or less 50% of the microfinance activity in the Western part of Europe.

Public money represents more than 80% of resources of these two networks. But one of these wants to escape this and become independent, and "financially sustainable". The other one explicitly wants to work with public money, considering that financing new businesses for people in trouble is a public duty.

This is a first difference between these two networks, meaning that they have developed very different conceptions of entrepreneurship. Is entrepreneurship a pure "free market activity"? Or is it a way to create collective wealth that deserves (and needs) to be supported by public policies?

The rising questions in the South are the same. The new influence of big foreign investors, very profit-oriented, in mature MFIs (microfinance institutions) in the South makes the situation very unstable; because the influence of these investors is based on a very simple conception of the job. This is pure financial transactions; profits are necessary to raise new resources; public intervention in these fields must be as limited as possible.

In France, the intervention of public money is completed by very precise public rules. It concerns two key points: the interest rate ceiling was fixed until recent changes; and it is forbidden for a lender to take the home of his client as collateral in case of a personal or a professional loan. These two points are at the heart of debates in the South.

Of course, the main differences between these two situations, in France and in "the South", make comparing MF development conditions impossible. Wealth in the countries is different; as is the concept of involvement of public money in MF; even the concept of the aims of MF differs; and finally, the concept of entrepreneurship as a model.

But the questions that arise now, after scandals like Compartamos, are probably not so different. Beginning with this one: Are "free market laws" able to share wealth created by the entrepreneur, between the entrepreneur and the lender? Does this relationship need an arbitrator?

2. In France, two different models of microfinance

2.1. Context, aims and visions

In France, two different networks act in the field of microfinance. Adie, the Association pour le Droit à l'Initiative économique, provides non bank microcredit to non-bankable persons who wish to become self-employed and reenter the labour market. The other organism, France Initiative serves a nearly bankable clientele through interest-free loans considered as quasi-equity facilitating access to bank loans; only part of its activity can be called microcredit.

The creation and growth of France Initiative followed a bottom-up approach. Since the beginning of the 1980s local business support programmes were established by professionals who had realized that many new entrepreneurs were hindered in the setting up of their project by refusal of bank credit. In 1985, 20 such local support programmes, today called "platforms" existed and were federated upon public and para-public initiative[2] into the umbrella organisation called France Initiative Réseau (the France Initiative Network), now called simply "France Initiative".

Growing steadily and rapidly, the network federated about 180 platforms in 1999 and 237 in 2003; today[3] it brings together 242 such platforms[4]. These are individual associations, often located in *Chambers of Commerce and Industry* buildings. Each platform mobilises and manages funds itself locally and transfers only a limited part of its own powers to the umbrella federation. In 2007, 509 full-time employees worked within *France Initiative* with 14 staff in the federation's head office in Paris and regional coordinating offices ensuring the platforms' representation on the regional level (France Initiative Rapport Annuel 2007).

France Initiative is focussing on entrepreneurship development. Its intervention is based on the finding that entrepreneurs have a hard time accessing bank credit and therefore alternative ways of funding for businesses have to be provided, beyond the traditional banking sector. Starting business is seen as one of the essential constituents of the "wealth" of a territory. Not only do the entrepreneurs create wealth (for themselves) as well as jobs (for the community), but the "entrepreneurial spirit" also positively influences the culture and the shared values inside this territory. The association targets new entrepreneurs, without any specific reference to social difficulties[5].

One of the development priorities of the France Initiative platforms is to intervene as lenders in the frame of social plans related to the threat of dismissals in order to support the projects of employees who would like to become self-employed. It can thus be considered as a contribution to the social aspects of local development politics. Therefore the France Initiative platforms can be considered as carrying out a solidarity action vis-à-vis the lenders who cannot find the necessary resources on the market; however this is not a "social action" in the strict sense of the word.

2 Para-public means the involvement of the Chambers of Commerce and Chambers for Crafts for instance.
3 As of March 2008
4 Plus around 150 local branches for reception of clients, instruction of projects or local credit committees (see notion of "credit committee" in chapter 2.1)
5 However some exceptions exist as for instance the Marseille platform that exclusively serves young persons in difficulty.

In contrast, Adie clearly focussed on social aspects. The association was established upon the initiative of three individuals in 1989, at a point in time when unemployment caused by the restructuring of the economy was becoming a major problem and the minimum social allowance scheme *RMI* had been set up[6]. The driving force behind the creation of Adie was Maria Nowak, programme manager at the *French Development Agency*, where she had successfully established group-based microfinance programmes in several West-African countries. She founded the association together with two friends who all came from the field of development cooperation – with the aim of helping unemployed persons in France realize their business initiative with the help of microcredit.

Initial funding was found from several private foundations[7], the public institution *Caisse des Dépôts et Consignations (CDC)*[8] and the European Union anti-poverty programme. Throughout its establishment and consolidation, Adie based its workforce on anti-military activists. In 1995 the creation of a specific type of contract facilitating the employment of young persons ("contrats emplois-jeunes") enabled Adie to employ staff. The association opened offices in a number of French towns, starting in Northern France, a region hardest hit by unemployment.

Between 1997 and 2001 the association grew from 25 to nearly 300 employees and from 110 voluntary workers in 1995 to 500 in 2002. However, the specific contract for young persons was abolished in 2002 and public authorities reduced their support to associations, slowing up Adie's exceptional growth. Today Adie has 369 staff members[9] working in 18 regional offices, 130 sub-offices and 380 'stand-by spots'[10] spread over the French territory and overseas[11] (Adie Rapport d'Activité, 2008). The main part of the association's norms, common functions and the network's back-office are centralised and thus represent rather a top-down approach.

Adie is deeply inspired by microfinance practice in the South, in the sense that it supports poor people in setting up an economic activity. However, in the context of an industrialised country, the focus lies more on fighting exclusion and unemployment than poverty as such. Maria Nowak's initiative was based on the idea that the high level of social protection in industrialised countries does not give people an incentive to become active and "develop their economic initiative", i.e. to create their own job if the labour market does not provide them with a job. It acts on the assumption that, when you give unemployed or excluded people the necessary resources to unleash their "hidden" capacities, they succeed as well as the national average and they pay back their credit well. It relies also on the idea that self-employment and business start-up correspond perfectly to the needs of the new economy.

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6 Unemployment rate of 10% in 1988 and 12% in 1993; Revenu Minimum d'Insertion (RMI) is a social allowance that applies to persons over 25 years of age who have exhausted their unemployment benefits or whose resources are inferior to a fixed ceiling.

7 La Fondation pour le Progrès de l'Homme, le Comité Catholique contre la Faim et pour le développement, Médecins sans Frontières, la Fondation de France

8 The Caisse des Dépôts et Consignations (CDC) is a French public establishment founded in 1816. It executes missions of general interest upon request of the French Government through its 25 regional offices. It is mainly involved in local economic development initiatives in cooperation with the municipalities.

9 Out of these 166 are loan officers.

10 In these cases Adie staff are present for a certain period of time (several hours or days) in partners' offices or Chambers of Commerce and receives would-be entrepreneurs.

11 Réunion, Mayotte, Guyana, New Caledonia, Martinique

2.2. Target groups

Adie serves those persons who have the most difficulties in (re-)entering the labour market. As such *Adie's* non-bank microcredit aims at progressively integrating excluded persons with low income into the normal bank circuit. Adie's main client group is recipients of social welfare minima (the so-called "RMI - revenu minimum d'insertion") paid to persons who have exhausted employment-based income support, although their percentage has decreased since 2003 when it reached a peak (54%); in 2008 the proportion of persons receiving social minima was 41%. Adie clients also include young persons from disadvantaged suburbs, travellers (Roma) and residents of rural areas[12]. Furthermore, the proportion of so-called "poor workers" (on part-time or interim employment) amongst Adie clients is increasing (3% in 2006; 7% in 2008). Recently, self-employed workers have become more significant, representing the association's willingness to finance the development of new microenterprises.

Regarding educational attainment, a significant part of Adie entrepreneurs have passed their A-levels (38% in 2006; 24% in 2008); on the other hand, an equally significant proportion has no or very little formal education (18% in 2006; 24% in 2008). One third of Adie clients are foreign-born or children of immigrants and 38% are female (36% in 2007) (Adie Rapport d'Activité 2008).

Adie entrepreneurs above all wish to create their own job. They have limited financial assets to invest in their businesses. Projects need on average a relatively low start-up capital of €10,000 and are mainly new sole proprietor businesses (Adie Rapport d'Activité 2007). In general, the association's clients mainly start their businesses in the trade, service and construction sectors.

France Initiative target groups

Trade and service are also the main business sectors of France Initiative clients. However, in contrast to Adie, France Initiative is more strongly focussing on entrepreneurship development than fighting unemployment. *France Initiative* serves a nearly "bankable" clientele; the association targets new entrepreneurs, without any specific reference to social difficulties[13].

France Initiative entrepreneurs provide 25% of the global start-up capital themselves. Business projects have average start-up capital needs of €71,000, which is seven times greater than an *Adie* entrepreneur's average start-up capital, and they create on average two or three jobs. Thirty percent of *France Initiative's* support to enterprises concerns business take-overs, and 55% of financed take-overs have budgets of more than €75,000 (France Initiative Réseau, Rapport Annuel 2006 and 2007).

The majority of *France Initiative* clients, 66% in 2007, are unemployed. However, a more detailed survey shows that according to their statements, only 40% of them were "involuntarily unemployed"[14] and only 25% were unemployed for more than one year. It is thus possible that a part of the client group voluntarily gives up their job in order to start a

12 Communities with less than 5,000 inhabitants.

13 However some exceptions exist as for instance the Marseilles platform that exclusively serves young persons in difficulty.

14 Enquête TMO Régions, Mars 2000

business. Client profiles also vary from platform to platform. Twenty-five percent of the association's clients are young persons below 25 and 33% are women (France Initiative Réseau, Rapport Annuel 2007).

2.3. Operational models

As is the case for microfinance in developing countries, Adie tries to link the financial and the social logic, inspired by the idea that it is possible to lend to the poor while covering one's own costs. From the beginning Maria Nowak was convinced that once Adie had achieved sufficient maturity, it would need to cover the cost of its credit activities and follow the logic and the financial organization of a microfinance organisation in the South. This logic of achieving - at least partial - sustainability was reinforced over time as the association had to cope with a decreasing level of support through subsidies from the public authorities.

In contrast, the basis of the France Initiative network's philosophy is the reference to the "common good". Business start-up is considered as part of local development and the creation of the "wealth" of a territory. It is considered legitimate that the production costs and the erosion of the capital provided are covered by (public or private) subsidies.

Beside loans, both organisations also provide BDS services. These are and will remain heavily subsidised in the two cases.

2.3.1. Loan models

Loans with interest

Adie's approach to microcredit is based on the microcredit concept developed by Mohammed Yunus, founder of *Grameen Bank* in Bangladesh. In a first attempt, *Adie* had transferred the *Grameen Bank's* solidarity group model to the French environment. The potential clients were found in cooperation with associations of social assistance such as *Médecins sans frontiers* and *Emmaüs*. This group model approach, however, failed, as it turned out not to be adapted to the context of an industrialized country characterized by strong individualism.

The association therefore turned to individual loans. In 1992, Adie also reoriented its strategy of finding clients, approaching more business associations than associations of social assistance. It thus started to cooperate with organisms in the field of business creation such as the *Chambers of Commerce*, local associations and the national network of *Boutiques de Gestion*. It re-centred its working strategy, focusing more strongly on support for economically viable projects in order to make sure the credit would be repaid. Specific attention was moved to the personality of the client and a credit committee was established to decide on loan provision. The decision was also taken to ask for a financial guarantee from the entrepreneur's entourage covering 50% of the credit amount, ensuring that the entourage could bring pressure to bear on the client in case of non-repayment.

For the credit activities, partnerships with banks have been set up since 1994. Until 2001 Adie was constrained in its credit activities due to the ban on associations on-lending to their clients. Adie therefore had special agreements with banks that disbursed the loans. Through intense lobbying Adie obtained an amendment to the French banking law which now allows the association to take out commercial loans and on-lend to the clients. For the association, this facilitates its management of loan provision, enables it to reach a larger number of clients and accelerates the disbursement of the loans. Within *Adie*, on average 30 days pass between the first contact and the provision of the microcredit. The average microloan amount is €2,750 for a period of 18 months. This can be augmented by subsidised loans without interest ("honour loans") as well as public interest-free so- called "EDEN" loans[15] and non repayable grants. Total financing of a project does not exceed €10,000.

Adie's aim is to cover the maximum part of its credit-related costs and, therefore, the interest charges on its loans. Until 2005 the usury rate was legally capped, restraining Adie from increasing this rate. However, raising the interest rate became possible when the interest rate cap for loans to individual entrepreneurs was lifted[16]. In 2007 *Adie* charged an interest of 7.98% plus a 5% commission. In order to know if they consider the increase in the interest rate legitimate, Adie has carried out several discussion groups with its clients. The surveys show that the clients attach more value to the comprehension, consideration and advice Adie offers them, especially in administrative issues, as well as the simplicity and the speed of the loan procedure than to the cost of the loan.

In order to track its microlending costs separately from the costs of training and technical assistance and to manage funds as effectively as possible, the association has separated the management of its credit poles from its BDS service poles. For 2008, Adie reports an increase of 15% of costs covered compared to the year before (Adie Rapport Annuel 2008).

To show that it is possible to achieve complete financial sustainability, Adie has also established six pilot branches called *Adigo* branches after having gone through a consultancy mission with a Latin American microfinance expert in 2007. These offices are located in densely populated urban areas and aim at addressing clients at the "bottom of the pyramid", proposing not only the normal individual microloans, but also group credit. A person who would like to take out a loan has to gather three other persons who each have an individual business project and need a loan. Each person in the group obtains a loan and needs to show solidarity for the loan repayment of each other member of the group. The method is based on mouth-to-mouth advertising. Each branch is under the patronage of a bank (BNP Paribas, Crédit Coopératif, Banque Populaire, Bred, Crédit Agricole) that funds the establishment of the branch (ibid.).

Loans without interest

In contrast, *France Initiative* neither aims at preserving the value of its capital nor at covering its production costs with the interest the lenders have to pay. The association considers the financing of new enterprises to be a duty of general interest; starting a business is seen as one of the essential constituents of the "common good" and the "wealth" of a territory. To achieve its objective, it considers it legitimate to accept public funding.

The reference to the common good has consequences regarding another area, namely the loan design. France Initiative provides exclusively so-called "honour loans" ("prêts d'honneur") which it considers to be the opposite (or the complement) of loans with interest. The "honour

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15 EDEN loans are public loans directed at young persons and beneficiaries of social minima.

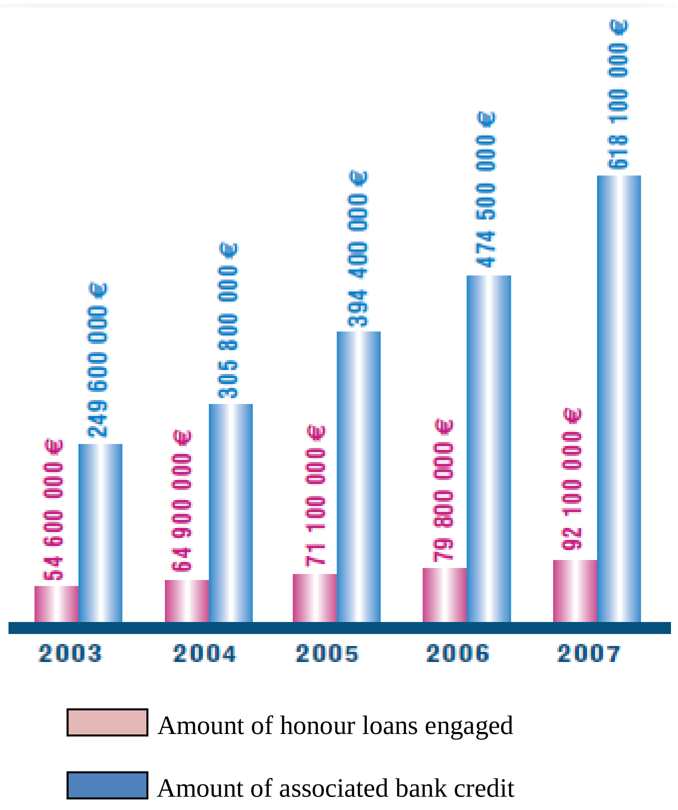
16 SME Law in 2005 - The Law included the drafting of a report from the Banque de France evaluating the impact of an abolished usury rate. This document points out that the abolishment of the usury rate has globally improved the funding mechanisms for MSMEs and has not produced the perverse effect of excessively high interest charged on loans that had been feared by many.

loan" concept is based on "confidence" - no guarantees or warranties are asked for - and it links this to an "ethical use of public funds": not to transform subsidies into loans with interest. In addition to an honour loan, public EDEN loans and grants are provided.

The final decision over credit provision is taken by a credit committee (as is the case with Adie), made up of volunteers with a business, bank or legal background. The role of the credit committee is to evaluate the projects, after a presentation made by the entrepreneur himself/herself, and to determine the type of service provided (honour loan, mentoring, "parrainage"). The average amount of a *prêt d'honneur* was €7,400 (between €3,000 and €40,000) in 2007 to be reimbursed over three to five years. This amount has been rather stable over the years, averaging around €7,100 from 2000-2003.

The specificity of the "honour loan" is its leverage effect. In fact, the great majority of the projects financed by a *France Initiative prêt d'honneur* (90% in 2007) are used to leverage a bank loan, with a leverage effect of more than seven (7.6 in 2007; 7.4 in 2006) (France Initiative Rapport Annuel 2007). In the majority of cases, the average total loan amount is thus €66,800 (€7,400 + €59,400), an amount that greatly exceeds the maximum amount set by the European Commission for microcredit (€25,000).

Graph 1: "Prêt d'honneur" leverage effect



Source: France Initiative Rapport Annuel 2007

2.3.2. BDS

Besides the credit itself, BDS[17] services are of the highest importance in France as in the whole of Europe. They enable new entrepreneurs to face administrative procedures, implement accountancy and management systems, establish a bank relationship and identify commercial opportunities. In addition, they reduce the risk of non-repayment of the loan. For business support, both organisations rely strongly on volunteers. Both organisations therefore provide business support during the whole period of reimbursement of the loan.

Adie revised its support strategy in 2007 and developed a new set of business support services. It provides individual level as well as group training covering administrative and legal issues, management, accounting, marketing and banking. Specific business support programmes have been developed for young persons and persons with particular difficulties (i.e. who do not speak French fluently). Since 2007, Adie also runs a telephone hotline, intended to detect difficulties in a business before they become too hard to manage, as well as computer training in cooperation with private firms.

France Initiative network members assist the entrepreneurs in the development of their business plans and access to finance, and help link entrepreneurs to an appropriate bank. In addition, each entrepreneur may be individually mentored by a mentor (‘parrain’), a (former) business manager who monitors and supports the would-be entrepreneur and introduces him or her into local business networks. In 2007, 6,600 entrepreneurs, i.e. about 30% of entrepreneurs supported by *France Initiative,* had a mentor of this type (ibid.).

2.4. Funding models

The two associations present relatively similar sources of funding, especially in regards to their business support services. However, it can be stated that France Initiative relies much more on local authorities for its funding, reflecting the association’s mission in local enterprise development.

Since the possibility has been established to borrow for direct on-lending, Adie has negotiated credit lines for a period of two years with about 40 banks regarding its microloan portfolio; they represent 70% of the portfolio resources. The rest of the microloan portfolio is financed through own funds and employees’ savings. For the overseas activities, the Agence Française de Développement (AFD) provides funds and credit lines. The “honour loans” (considered as quasi-equity) that Adie provides as a complement to its microloans are funded by the Caisse des Dépôts et Consignations (22%), banks (41%), enterprises (13%), local authorities (21%) and European funds (3%) (2008).

Adie’s business support is 82% funded by public sources and 18% by private sources. Funding comes from the European Union, the government, local authorities, the Caisse des Dépôts et Consignations, socially responsible enterprises and foundations.

France Initiative’s loan portfolio is financed up to 50% by the local authorities (21.5 % by the regions, 16.2 % by the departments and 12.3 % by the municipalities and inter-communal structures). 6.3% is funded by European Structural Funds, mainly Feder and Leader. The

17 Business Development Services

Caisse des Dépôts et Consignations contributes 17.3%. Additionally, 9.7% is brought in by banks (representing an increase of 0.7%). Finally, enterprises contribute 8.2%, notably local MSMEs (representing 20% of that contribution).[18] The remainder is funded by other private sources as well as consular chambers.

The platforms' budget is 47.1% financed by the local authorities: 17.9% by municipalities and inter-communal structures, 15.3% by the departmental level and 13.9% by the regions. Furthermore, 13.4% represents remuneration for the management of public programmes and 10.5% stems from European funds, above all the European Social Fund.

The functioning of the Paris headquarters is financed by the Caisse des Dépôts (28.8 %), the French government (28.7 %), the European Social Fund (18.8 %), businesses and banks (6%). The membership fees paid by the platforms represent 12.5 % of the budget.

2.5. Analytical tools - Lenders' efficiency

2.5.1. Strategies

2.5.1.1. Tools, products, legal changes

Adie's exceptional growth is the result of several legal changes enabling the association to operate more efficiently (such as the authorisation to borrow for on-lending and the lifting of the interest rate cap), the establishment of a more favourable environment for microenterprises and self-employment as well as Adie's internal re-structuring: the revision of the loan cycle, the establishment of a central telephone reception in 2003, an internal control programme and an improved information management system. This is completed by constant search for new partnerships and testing of new products and programmes as well as major communication campaigns such as the annual "Microfinance Week". In 2009, Adie will launch "Adie Connect », allowing clients to apply online.

Diversification of products and setting up of new programmes in partnership with public and private actors is one of Adie's main strategies to serve more people in an adapted way. Adie has introduced group loans for immigrants, especially sub-Saharan African women, as well as step loans for people who run small income-generating activities, often in the informal sector, in order to help them develop and formalise their activity, and microloans for the development of a business. Since 2006 the association runs a project called "Projet Banlieues" in collaboration with the BNP Paribas bank aimed at supporting the start-up of 700 new enterprises in deprived French suburbs from 2006 to 2009.

In addition, in 2007, the association launched the "Créajeunes" programme that is intended to boost enterprise start-up amongst young unemployed persons in deprived urban areas. It provides pre- and post start-up training and a start-up grant of €500 plus a microcredit. Another project called PADRE is intended to better inform people in rural areas of the possibilities of microcredit and to estimate the demand for this service. It is based on the idea of mobile branches. Since 2006 Adie also runs a pilot programme on personal microcredit for integration into the labour market in the frame of a programme set up at the national level by the government. In 2008, 165 personal microcredits were provided, used principally for

[18] micro-, small and medium enterprises

buying or repairing a vehicle, or for passing the driver's licence for work purposes. And last, but not least, the association has also set up a microinsurance initiative in partnership with the insurance companies *Macif* and *AXA* that merged in May 2007. It is currently being tested in three big French regions. The offer includes several pillars that can be chosen depending on the entrepreneur's specific needs. After a maximum period of three years the microentrepreneur's contract reverts to the usual insurance contracts. Up to the end of 2008, 549 microinsurance contracts had been taken out (Adie Rapport d'Activité 2008). In another region, where an additional 153 contracts were signed, Adie works together with an association called Entrepreneurs de la Cité, a microinsurance association set up in 2004.

France Initiative for its part does not develop new products as such, but focuses on engagement in new local economic development programmes as well as on developing efficient communication strategies with partners and reliable business development services.

2.5.1.2. Public and private partnerships

Beside the development of new tool, products and communication strategies, building up partnerships with private and public agents is an important step that both organizations have taken – beyond funding only. Both work in close collaboration with a number of public and private partners. Adie has set up a number of partnerships with public organisms as well as banks and enterprises. These partnerships concern the funding of Adie branches, funding and support for BDS and support for events such as the Microcredit Week[19]. The association established its first bank partnership in 1994-95 with Crédit Mutuel that became interested in the association after a TV report about Adie had been shown. Subsequently other banks joined, the Municipal Credits (Crédits Municipaux), Crédit Coopératif, Banque Populaire, Caisses d'Epargne, all cooperative or mutual banks, thus increasing Adie's financial means.

National and local public organisms such as the Caisse des Dépôts et Consignations are also amongst the partners. The national employment agency ANPE refers unemployed persons to Adie. The Ministry of employment and vocational training has established contracts for the promotion of employment with the association and partially funds its BDS services. The Ministry for Trade, Handicraft and Small Business, and the Ministry for Urban Development have set up pilot programmes, fund new branches and provide support for Adie's work with specific target groups. In addition, Adie has established partnerships with the local authorities.

Regarding BDS, technical partnerships with a certain number of companies have been developed. For instance, since 2005 the project 'L'informatique en 3 clics' ('Computing in 3 clicks'), in cooperation with *a big computer firm*, provides Adie clients with a three-day free of charge computer training as well as the opportunity to buy a used computer at a preferential price. Seventy training sessions of this kind were provided in 2007 with very positive feedback (Adie Rapport d'Activité 2007).

For *France Initiative,* banks and financial institutions are also very important partners - they act as a complement to the 'honour loans". In 2007, 1,420 local partners were reported, an increase of 5.8% compared to 2006. For its BDS, France Initiative has also developed technical partnerships with a number of stakeholders, such as the Chambers of Commerce, the communities, development agencies, business support networks, accountants, banks,

[19] Each year, during one week all over France, Adie organizes forums in public places such as stations, markets and commercial centres to present its activities, provide information and receive people who would like to become Adie clients.

government services etc. On average, the platforms have six partnerships relating to the initial reception of the new entrepreneurs and four partnerships for setting up the business plan (France Initiative Rapport Annuel 2007). Moreover in 2007, the platforms set up 817 partnerships with large enterprises, an increase of 4.6%. 4,250 partnerships exist with very small and small enterprises, representing an increase of 10% compared to the year before; out of these, 1,250 are actually enterprises that had themselves received support from France Initiative for their setting up.

2.5.1.3. Staff productivity

Adie reports that each loan officer accompanies 125 active clients per year. Fixed objectives are set each year. As such the strategic plan 2008-10 sets the objective of a 20% annual increase of loans provided to reach 115,000 in 2009, 8,000 in 2010 and 22,000 in 2011.

Adie dedicates significant financial means to the training of its staff. As such the annual budget for staff training is around 4% (Adie Rapport Annuel 2008).

France Initiative reports that a correlation exists between the dimension of the team and the number of enterprises financed: on average, 32 enterprises are financed by platforms with an average equivalent of one person working full time; at the other end of the continuum, on average 140 businesses are financed by platforms with an average of 5 or more full time workers. France Initiative reports that the average size of a local team is 2.9 persons. These are on an average assisted by 55 volunteers active in one platform. Overall 13,100 volunteers were actively engaged in the work of *France Initiative* in 2007.

Besides fixed staff, volunteers are the backbone of the organisations' work. They are mainly involved in BDS provision as advisors, mentors and trainers and active in the credit committees determining loan provision. *Adie* works with an extensive network of 1,000 volunteers. Overall, 4,700 mentors were engaged in the work of *France Initiative* in 2007. Most volunteers are recent retirees and active professionals in the business and banking sectors.

2.5.2. Portfolio quality

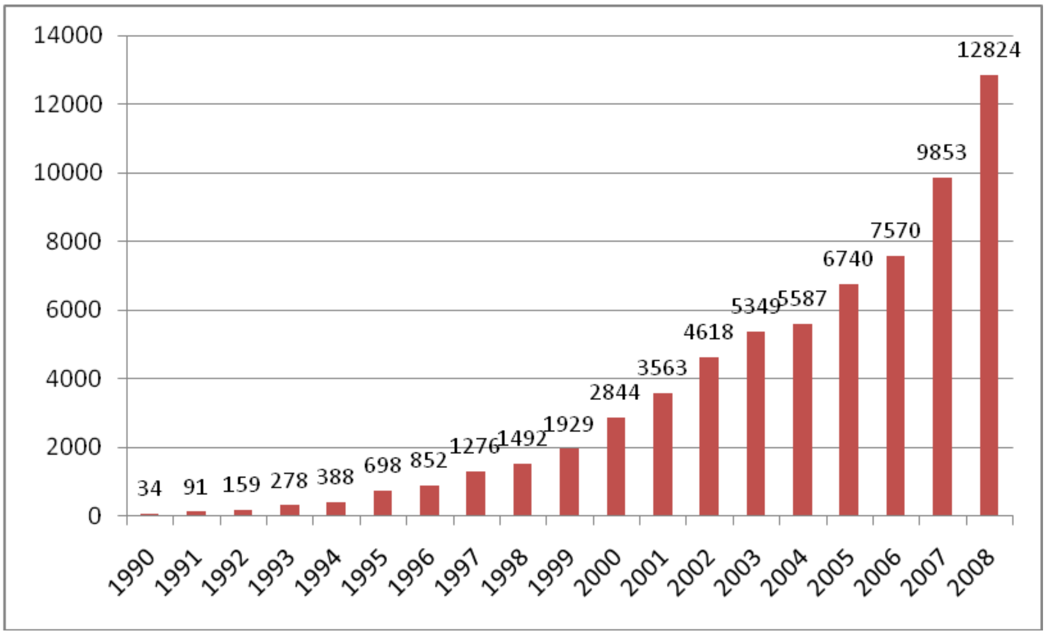
In 2008 Adie had a 6.58% delinquency rate and a 2.58% loan loss rate. Delinquency rate averaged around 8% in 1998; since then it has decreased and remains steady between 6 and 7%. The Adie microloan portfolio is backed by two guarantee funds, the FGIE (Fonds de Garantie pour les structures d'Insertion par l'Economique, fed by the Fonds de cohésion sociale; which means public money from the Caisse des depots et consignations) and the EIF (European Investment Fund). These funds take over a part of the arrears: FGEI guarantees 70% of the outstanding balance of the loan principal and EIF up to 75%. Additionally, the banks that provide credit lines to Adie take over part of the risk (30% of the credit line provided). Several local credit and loan funds also guarantee part of the portfolio. As such, Adie's risk exposure is 10% of the portfolio.

France Initiative reported a repayment rate of 96.6% for 2007.

2.5.3. Scale and impact

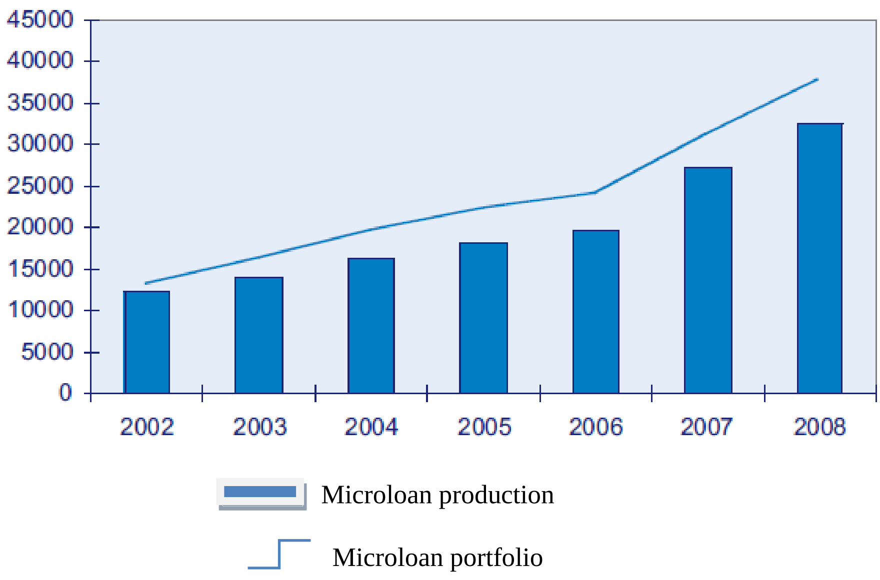
Having provided 34 loans in 1990, 3,000 up to 1996 and 7,000 up to 1999, Adie has disbursed 65,209 microloans and more than 13,100 prêts d'honneur up to the end of 2008. In 2008 alone, Adie provided 12,824 loans representing a 30% growth compared to the year before. Following the trend that appeared in 2007, Adie's microloan portfolio has strongly increased, standing at about €39 million in December 2008, which represents an increase of 24.8% in total microloans provided to clients. (ibid)

Graph 2: Evolution of Adie microcredit production



Source : Adie Annual Report 2008

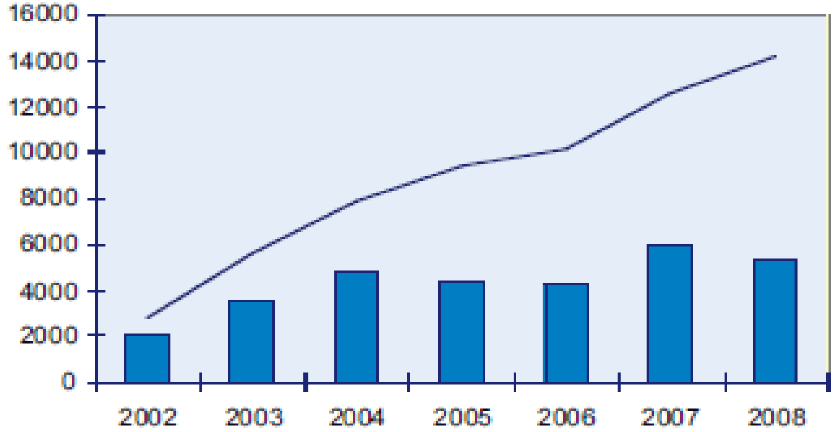
Graph 2 : Microcredit production and portfolio



Source : Adie Annual Report 2008

The portfolio of "honour loans" was €14 million at the end of 2008.

Graph 3: "Honour loan" ("prêts d'honneur") production and total portfolio



Source : Adie Annual Report 2008

Adie also disbursed 3,210 interest-free government EDEN (Encouragement au Développement d'Entreprises Nouvelles – Promotion of New Enterprise Development) loans and 3,568 regional or departmental grants.

Adie has financed more than 55,400 new enterprises and created more than 66,511 jobs. In 2008 alone it financed 11,810 new jobs. The survival rate for new enterprises in 2008 was 65% after two years and 57% and after three years, remaining stable over the years[20]. The new businesses create on an average 1.2 new jobs. What is even more important: 80% of the persons Adie supported in the last five years have quit welfare schemes and become reintegrated into the labour market[21]. Furthermore, an evaluation carried out by Adie in 2003 showed that business closure is often the result of a personal choice (25%) of family or health constraints (15%) rather than an unhealthy business (Adie Rapport d'Activité 2008).

France Initiative represented 4.2% of all business starts in France and 14.8% of the bank support for business creation in 2007 (France Initiative Rapport Annuel 2007). The federation provided 12,500 *prêts d'honneur* in 2007. According to a study carried out by *Adie/EMN in 2008 for the European Investment Fund,* an estimated 5,000 of these enabled the beneficiaries to access a bank microcredit (below €25,000 which is the maximum amount for microloans as defined by the EU)() [22]. Over recent years, the network's activity had grown considerably. While €32.3 million were provided to 4,500 new and existing enterprises in 2000, the credit portfolio amounted to €54.6 million disbursed to 7,650 businesses in 2003. The 2007 loan portfolio was €92.1 million. This was accompanied by €618.1 million of bank

20 The national average is 66 % after three years according to the study Insee SINE 2002-2005.
21 This rate is called 'rate of integration' ('taux d'insertion') by Adie.
22 The number of 5,000 loans below €25,000 is very approximate though. It is based on the approach used in the Microfinance Market Study (Adie/EMN, 2008) used to calculate the number of microcredits provided by France Initiative in 2006: 41% of clients presented a budget of less than 30,000 Euros corresponding to bank loans of 25,000 Euros. (France Initiative Rapport Annuel 2007).

loans provided in addition to the honour loans (average leverage effect of 7.6), representing a 30% growth over the year before.

The provision of public EDEN loans decreased strongly in 2007 (-16%). In contrast, the provision of the OSEO PCE loan[23] increased by 70%. In addition, 82 platforms provide the FGIF guarantee for women entrepreneurs and 210 such guarantees were provided in 2007. The programmes of local authorities show a 6% increase.

In 2007, the network supported the start-up or take-over of 13,500 enterprises with a total of 30,500 jobs created during the first year of the activity, representing 11% more than in 2006. In 2007, the survival rate of enterprises supported by France Initiative after three years was 86% (France Initiative Rapport Annuel 2007) which is considerably higher than the national average.

The businesses that have received support from France Initiative show a high rate of development. A study carried out by France Initiative on a three-yearly basis in 2007 (the follow-up study of 2004 towards 1500 new entrepreneurs financed by France Initiative) states that seven out of ten France Initiative entrepreneurs have "considerably" developed their activity during the first two years of activity (La Lettre de France Initiative 127, March 2008). They employ on an average 3.9 persons (executive included) which represents a significant increase compared to 2004 (2.3 persons).

2.5.4. Social return on investment

Social Return on Investment, or SROI, was originally developed by the Robert Enterprise Development Fund (REDF) in the USA. Nef, the UK based think tank new economics foundation, has co-developed a global framework of this methodology to put a financial value on social intervention. The basic premise is that of engaging stakeholders into describing how they define success of the intervention. In 2005, the UK based microcredit organisation WEETU carried out an SROI. The result was encouraging: for every £ invested in WEETU, £5.80 of social value is created.

Although no specific studies in this regard exist, both Adie and France Initiative intend to show that the cost of job creation supported by them is lower than the costs of social benefits paid to the person if he/she would have remained unemployed, while also resulting in increased taxes paid to the government. France Initiative has calculated the cost of its activity: generating or maintaining a job cost 1,189 € in 2007, out of which 162€ stemmed from the State, 128€ from Europe and 521€ from the local authorities. This amount takes into account the operating costs of the whole association (the platforms and the headquarters) as well as the provisional lost of funds due to delinquent loans.

Equally, Adie has calculated its cost incurred for the setting up of one business. The association assessed the cost of an 18 months business support at €2,500. However as the

[23] The Prêt à la Création d'Entreprises (Business Start-Up Loan Programme) managed by Oséo is an unsecured loan valued at between 2,000 and 7,000 euros available with a 6 month deferment on principal payments and a maximum loan term of 5 years. This loan must be accompanied by a bank loan. Its purpose is to assist entrepreneurs to increase their own investment in the business thereby facilitating the bank loan. Oséo can also guarantee up to 70% of the value of the bank loan. Since the launch of the PCE at the end of 2000 until April 2007, more than 82,000 Prêts à la Création have been disbursed.

clients do not use all of the services, the average cost per business was calculated at €1,655 in 2008.This represents the functioning cost divided by the number of projects, but does not include the work of the volunteers.

2.5.5. Social impact (Cerise SPI)

In 2007 Adie carried out a study with the aim to develop a score for social and financial exclusion, together with the French association "CERISE"[24]. In 2008 Adie implemented data collection of this indicator; this enables Adie to assess who are the clients it reaches out to. The score is made up of roughly 15 indicators of exclusion. The individual score of a client may vary between 0 (the less excluded) and 19 (the most excluded). The study showed that on the national level, the score of Adie clients has remained stable over the years between 8.10 in 2006 and 8.56 in 2008, in spite of the association's strong growth. This shows that Adie continues to effectively reach out to its target group and continues to fulfil its mission. (CERISE, 2007)

Moreover, in one of the evaluations carried out on Adie's initiative in 2001, the association has surveyed persons who failed after having taken out a credit. It seems that the great majority of these persons remain with a very positive perception of the experience they had with Adie; it has allowed them to formulate their personal projects and to realise their projects. Thus, à priori, the business failure does not put the concerned persons in great difficulties.

Partial evaluations were also carried out in 2001 and 2003[25] about the impact of Adie's loans on their clients' lives. The survey shows that even if businesses fail, the majority of Adie clients (75% at that date) have actually found a new job and left the system of social benefit. This is what Adie calls the rate of integration ("taux d'insertion"). The study also revealed Adie clients' level of salary in the first and second year after business start. In general their salary is quite low; it lies around the same level as the social minima they had received before. In 2003, half of the clients estimated that their financial situation had improved with the starting of their business. For 45% of the new entrepreneurs, the revenues coming out of the business were however not sufficient to pay the household charges (this concerned 40% -3 years after the business start). The great majority of them dispose of additional revenues (differential RMI, spouse's salary etc.)(Adie Rapport Annuel 2003).

Amongst positive social effects, Adie notes access to a complementary health insurance: after three years of activity, 70% of the new entrepreneurs have one. In contrast, only a minority is able to save money and to pay into the complementary pension system.

Finally, the study shows that only a very small minority of the interviewed persons (3%) would prefer to enter salaried employment again. The majority stress the positive issues such as autonomy, personal satisfaction and their desire to develop their activity (ibid.).

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[24] CERISE : Comité d'échange, de réflexion et d'information sur les systèmes d'épargne-crédit. A French think tank founded by the four biggest French NGOs involved in microfinance in the Southern countries
See : http://www.cerise-microfinance.org/

[25] The 2003 survey was carried out with a panel of 2,300 persons financed by Adie during the last five years.

As mentioned above[26], since 2004, France Initiative also regularly analyses the impact of its activity. These surveys do not focus on the social impact, but on the problems the business might have encountered as well as the development of the financed enterprises. One third of the interviewed entrepreneurs state that they have not encountered any problems with their business. Those who have had problems, cite financial problems (23%), a commercial problem (18%) or problems with staff management (12%). 55% state to have reached their initially set turnover, 47% the initially planned working hours and 37% state to have reached the initially planned salary. Moreover, a large majority (89%) of the interviewed entrepreneurs (89%) state that they would start again if they had to (74% “certainly” and 12% “probably”). (La Lettre de France Initiative 127, March 2008)

Half of the interviewed entrepreneurs stated to still be in contact with the platform. However, in case of problems, they do not contact the platform team, but rather accountants, spouses, friends and associate partners.

41% of those who have closed down their activity did so one year after the business start, mainly due to financial problems, market-linked problems and personal problems. Nearly one out of two has become a salaried worker again.

2.6 Conclusions on two MF models in France

Both organisations have reached considerable results; together they have provided more than 25,000 loans. They work very efficiently while reflecting different visions, aims and operating models. Both organizations were set up in similar political and economic contexts, but they operate upon different models and target a different clientele.

Public money represents more than 80% of the resources of the two networks; but while Adie wants to escape this and become independent, and “financially sustainable”, France Initiative explicitly wants to work with public money, considering that financing new businesses for people in trouble is a public duty.

Beside these very evident and important differences regarding their visions and operations, both organisations nevertheless also work based on significant similarities: both rely heavily on the involvement of volunteers regarding their BDS provision and final decision on loan provision as well as on partnerships of all kinds, thereby keeping operational cost as low as possible.

[26] see chapter 2.5.3

3. In the South, the question of interest rates became controversial from 2006

It is necessary to look at these two images as symbols. MF (and especially the perception of MF by the general public) has changed radically. In 2006, the media continued to cover the subject as a series of naive success stories. The following year, at the end of 2007, the "Ugly Side" was put forward.[27]

In October, 2006:

Figure 1: The Good News

Source: Business Week

[27] From Chuck Waterfield of MF Transparency, a newly founded initiative for promoting transparent pricing in the microfinance industry. Waterfield's presentation in a slideshow was displayed in several conferences from last year. Chuk Waterfield is assistant professor at Columbia University and one of the most respected consultants in MF. He is the author of Microfin, software for MFI, and at the origin of MF Transparency with Muhamad Yunus. See also : Chuck Waterfield : "Understanding annual percentage rate (APRs)" – 28 Sept 08 http://www.mftransparency.org/media/pdf/UnderstandingARPs.pdf

In December, 2007[28]:

Figure 3: ... and the bad press a year later

Source: Business Week

Three points justified the criticism from the media:

- The fact that the interest rates of institutions that claim to practice MF are equal to, sometimes even higher than the interest rates of banks and even moneylenders;
- The fact that these MFIs contribute to the over-indebtedness of the poor;
- And finally, the fact that the profits of some MFI shareholders (including external investors) are considerably higher than the profits of comparable mainstream banks;

The survey "The Ugly Side of Microlending Business" published in Business Week shows the extremely rough context of credit in Mexico - on the side of the registered lenders (especially consumer credit companies) as well as of certain MFIs.

Business Week quoted interest rates of:

Compartamos (a leading MFI): 105 %

Banca Azteca (consumer loans): 90 %

WalMart (a retailer, which obtained a license to lend): 80 %

[28] See Keith Epstein and Gery Smith : « The Ugly Side of Microlending », Business Week 13 Dec 07. See : http://www.businessweek.com/print/magazine/content/07_52/b4064038915009.htm

Subsequently, a long survey was published in The New York Times[29], describing the constraints and the injustices connected with "the commercialization" of MF, including an interview with the managers of Compartamos.

3.1. Compartamos represents a turning point in the perception of interest rates in MF

The Mexican MFI Compartamos became listed on the stock exchange in 2007 - as a confirmation that microfinance had entered a new phase in its history.

The Compartamos story is now well documented. From the point of view of interest rates, it is clear that this MFI charged very high rates.

Three points deserve to be highlighted:

The source of the profitability: Compartamos constantly charges an interest rate of around 100 % to poor women and has never changed its conditions, even when the evolution of its performances allowed it to do so. Besides, as Chuk Waterfield shows, the advertising for the loans contained traps making the real, global price of the loan (APR) incomprehensible.

The company executives bought shares in the company in 2000 and sold them just after it became listed on the stock exchange. Their profit was around 300:1 (they bought shares for one peso in 2000 and sold them for 300 pesos in 2007). This high profit supposes that they managed the development of the company with regard only to their personal profit.

Finally, and this is probably what is the worst, the comments about this behaviour have been divergent. A note from the CGAP written by Richard Rosenberg, the person who in 2004 with Elisabeth Littlefield, CEO of CGAP, was the author of the forceful citation put at the head of the present paper, is also the one who wanted to provide a sort of justification for this operation. He explained notably that even if the profits had not been so high, the interest rates applied to the customers would not have been very different.

In 2007, Compartamos had an ROE (return on equity) of 47.9 %, compared to "20 - 25 % for Latin American banks", according to JP Morgan in April 2008[30]. This makes this "bank for the poor" much more profitable for its shareholders than a "traditional" bank.

Alex Counts, president of Grameen Foundation in Washington noticed that "the poor customers are at the origin of the profit, but are excluded from it". Lynne Patterson, one of the founders of Pro Mujer, an IMF that operates in several Latin American countries, had the same reaction: "We reinvest the profit in the services proposed to the customers", she said, explaining that with the profits from microcredit, her organization finances health and educational programs for the poor[31].

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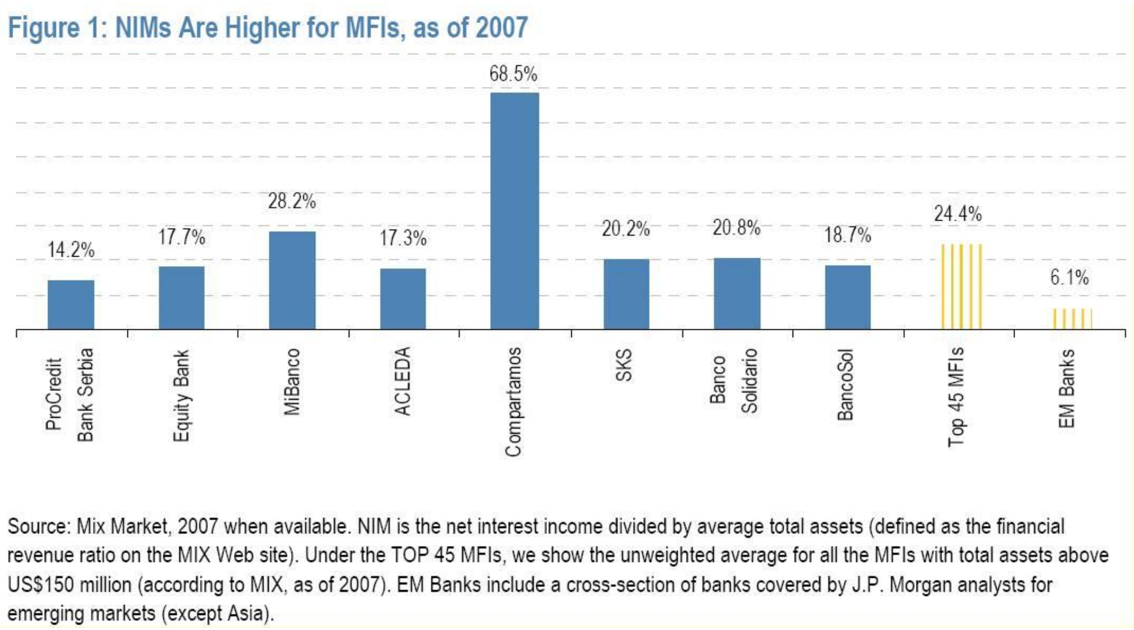
[29] NY Times : http://www.nytimes.com/2008/04/05/business/worldbusiness/05micro.html?_r=3&scp=1&sq=compartamos&st=cse&oref=slogin&oref=slogin
[30] JP Morgan Latin America Equity research: Banco Compartamos, 29 April 2008
[31] A good synthesis of debates is here: « The Implications of Increased Commercialization of the Microfinance Industry : What can we learn from the discussions that followed the Compartamos IPO?", by MFI Solutions, LLC, USA, July 2008
See: http://www.microfin.com/files/Implications%20of%20Increased%20Commercialization.pdf

Some months later, M. Yunus presented the creation of MF Transparency with Chuck Waterfield, stating in an interview with Business Week that: “Microfinance was created against the abuses of moneylenders. We do not want usurers to act in the name of the microfinance.”[32]

3.2. Several studies confirm that the profitability of big MFIs exceeds that of comparable banks

In February 2009, a new study carried out by JP Morgan and CGAP shows that Compartamos remains far above the others in terms of financial performance (net income : 68.5%). This is true when compared with other MFIs (24.4 %) but especially when compared with the sample of banks in the so-called “emerging markets” analyzed by JP Morgan (6.1 %).

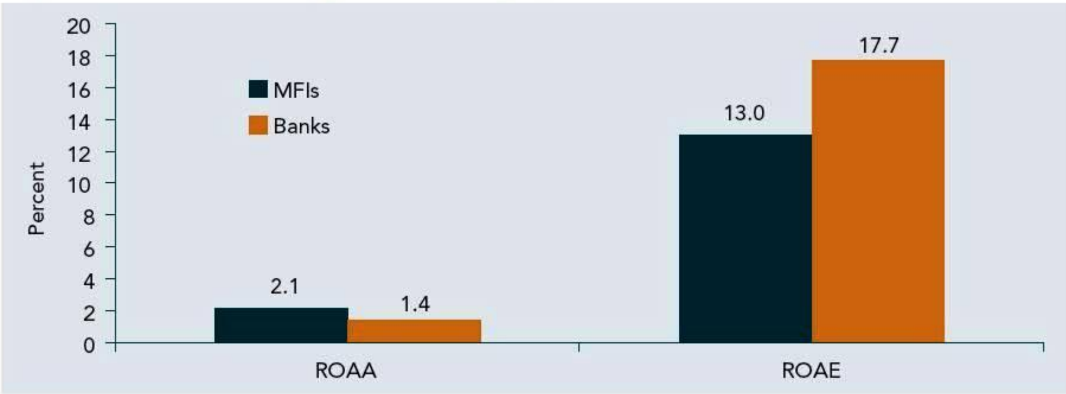


Legend: picture from the JP Morgan – CGAP survey: « Global Equity Research, Microfinance - Shedding Light on Microfinance Equity Valuation: Past and Present » - February 3rd, 2009. Available on JP Morgan's and on CGAP’s sites: < Http: // www.microfinancegateway.org/files/55483 _file_OP14v3.pdf >

[32] See : http://muhammadyunus.org/content/view/158/128/lang,en/

Another study by CGAP (February 2009) shows rather different results. But the figures from the survey (above) comparing MFI with " emerging countries " banks seems more realistic.

Figure 10: Returns on Average Assets and Equity—MFIs vs. Banks



Note: Asset-weighted averages of all MIX MFIs with 2006 data available, except BRI Unit Desa, whose reported equity is artificially low because of its relationship to the larger bank. Most MFIs in the sample report to MBB, where their returns are adjusted to compensate for the effects of subsidy. Bank data by Christoph Kneiding, based on the most recent year available in Bankscope, for countries that have MFIs reporting to MIX.

Legend: comparison of returns on average assets and equity, in Rosenberg and al. « The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates? », CGAP, Feb 09. <http://www.cgap.org/p/site/c/template.rc/1.9.9534/>

3.3. CGAP and advisers of foreign investors confirm the objective of profitability: "If there is no competition, why lower the interest rates?"

Compartamos loans are short-term (on average 4 months) and the small repayment amounts are "less painful" for the customers, says JP Morgan. That's where the suggestion from JP Morgan to Compartamos emanates from: « If there is a low level of competition, why lower the interest rates? ». In its forecasts, JPM foresees that the average amounts of the loans would increase – and with this also the productivity and the global return, so that there are no reasons for lowering the loan rates. In this analysis, JPM's optimism also stemmed from the fact that few correlations existed between the price of the MFI's shares and stock exchange valuations. In other words, if the stock exchange fell, the Compartamos shares and the other MFIs would become "shelters" for investors.

But the angry activists who accused the CGAP "of justifying an operation which enriches the rich shareholders of the North by impoverishing the poor customers of the South" found some first proofs. The shares that were quoted at 40 pesos in the beginning rose to 69 pesos in July 2007. Maybe skilled initial subscribers on the NYSE sold their shares and "took their profit" in three months?

3.4. CGAP and JP Morgan justify the high interest rates through contradictory reasoning

The justifications for highly priced loans are well known: production costs are the main cause, because the link between the loan amount and the cost is proven. This is stated by Waterfield and CGAP. Richard Rosenberg used this argument to explain that even if the loans of Compartamos had been lower, it would not have changed the rates.

The CGAP has again used these arguments in a recent paper[33]. The conclusion is the same:

"In today's microfinance industry, there is still some debate about whether and when long-term subsidies might be justified in order to reach particularly challenging groups of customers. But there is now widespread agreement, within the industry at least, that in most situations MFIs ought to pursue financial sustainability by being as efficient as they can and by charging interest rates and fees high enough to cover the costs of their lending *and other services*"[34].

In 2008, JP Morgan extended its "research" subjects beyond Compartamos and published, together with CGAP, in February 2009, a paper[35] clearly dedicated to private investors who hesitate to put money in MF, or who look for the best targets corresponding to their criteria. The main subject of this paper is a methodological question: how do we establish a market value for MFIs, notably by comparing them with the valuations of banks?

The study examines a sample of 60 MFIs and 10 listed "financial institutions for low income customers". The sample includes consumer loan institutions that "do not have explicit social aims". This is an understatement: obviously, private financial institutions that provide consumer loans do not take care of the professional activities of their customers. They give loans by using personal, often very sophisticated scorings. The study shows moreover that the annual cost of the overdraft loans in Latin America varies from 43 % (Inbursa) to 152 % (GE Money).

In this paper, JP Morgan and CGAP state that net profits on interest of the MFIs are higher than those from traditional banks. For the authors, three reasons "justify this level of interest rate in microfinance":

"1 -The financial explanation: Higher operational costs justify higher interest rates."

"2 - The microeconomic explanation: Micro-companies are profitable."

"3 - The macroeconomic explanation: The competition is limited."

This completely "free market" explanation allows the authors to introduce MF "as a class of assets among others", particularly profitable; and this in February 2009 - in the current period of challenging the efficiency of financial markets.

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[33] Richard Rosenberg, Adrian Gonzalez, and Sushma Narain : « The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates? »; CGAP occasional paper, No. 15, February 2009 http://www.cgap.org/p/site/c/template.rc/1.9.9534/

[34] Underlined by the authors

[35] See : JP Morgan et CGAP : « Microfinance - Shedding Light on Microfinance Equity Valuation: Past and Present", Global Equity Research, 03 Feb 2009 http://www.jpmorgan.com/cm/cs?pagename=JPM/DirectDoc&urlname=MFI_Research.pdf

In fact, every word of this explanation deserves to be analyzed:

The MFIs "operational costs" are very high

The cost is what makes MFIs radically different from traditional banks. As an MFI addresses people excluded from financial services, the role of the MFI often includes a contribution, in the form of advice, to the projects of poor and unaware customers. This takes time and if no public budget is available it weighs heavily on the lender's production cost. However, what is presented by JP Morgan and CGAP as a "cost" in fact constitutes the essence of the job.

The analysis of CGAP is: the poor customers have to bear these costs alone. No alternative is suggested on this point: the purely financial logic requires that the poor customers pay highly, because they cost dearly.

Micro-companies would be very profitable.

The study quotes a previous survey by CGAP which appears to show a "return on investment of micro-companies from 117 to 847 %"[36]. Without even looking at how the sample was selected, it is particularly careless to apply the conclusions to all the customers of MF. Indeed, we know that MF addresses microentrepreneurs who are often on the verge of survival; without any assets or any means to negotiate; thus without real capacities to develop profitable businesses.

The micro-businesses that exit the grey economy can be very profitable during a brief period for this reason; but this competitive advantage will disappear quickly. This is also a well documented fact.

The competition is limited: thus, conclude the authors, the interest rates won't fall

The rates will not fall as long as there is no competitor for the same target customers. This reasoning consists in taking for granted that the lender's monopoly position has to benefit the lender, not its customers. The return is nevertheless against the rules of liberalism and the presumptions of the "free market".

Maximizing profit is the only aim. The MFIs' "double objective - social and financial" is quoted in the study; but only for the record: just to help investors detect those that make more profit than the mainstream banks.

[36] Based on a survey in India, Kenya and Philippines. CGAP special survey, by Helms & Reille, Sept. 2004.
In English http://www.cgap.org/gm/document-1.9.2703/OccasionalPaper_9.pdf
En français : http://www.cgap.org/gm/document-1.9.2652/OccasionalPaper_09_fr.pdf

3.5. Compartamos provoked a strong reaction from one part of the profession

The Compartamos scandal is only the beginning of a series of violent reactions regarding the excesses in MF. The incidents multiply, as in Nicaragua during summer 2008 when customers organized violent demonstrations because the lenders seized their houses. In Pakistan, farmers accuse MFIs of abusing their positions and impoverishing them[37].

In some big MFIs, the process of transformation into regulated financial companies has been strongly advised by international investors (Responsability, Blueorchard, Oikocredit, Alterfin, Microinvest, Globalpartnerships, etc.). The investors who buy a large portion of the shares in these MFIs take responsibilities in their management; thus the local founders are no longer responsible for decision-making. In one case in Nicaragua, the new management simply dismissed the founder of the MFI. In another case in Peru, the investors now hold five seats out of the seven on the Board. Thus the aims of profitability are henceforth defined by financial investors, and no longer by local managers.

Muhamad Yunus has repeatedly reacted to these two aspects: to the huge profits of some MFIs, and to the negative influence of the foreign investors on the strategy of MFIs[38].

3.6. MF succeeded in creating only one sort of transparency

The improvement in the transparency of MF is obvious. CGAP, the MIX market has been collecting data for years. But all this information is on financial performance (interesting for investors); not on loan pricing.

Chuck Waterfield explains that “we need transparency on prices” because “non-transparent pricing creates a serious market imperfection, generating the potential for high profits from lending to the poor. Thus: “ pricing transparency is essential to well-functioning markets, promoting efficiency, healthy competition and better prices for millions of poor people ”, because “ informed decisions and fair competition require a market price!”[39]

Thanks to the data base he uses, he proves that the price of loans depends strictly on their amount – this is confirmed by the analyses from CGAP. We know that the "production cost" of a €500 loan is about the same as that of a €5,000 loan: thus the impact of this, charged to the customer, obviously makes the small loan more expensive (being also one of the reasons why the big MFIs provide bigger loans).

However, the weakness of Waterfield’s reasoning is to consider that improving transparency in prices is enough to make the market work better, for the benefit of the poor. The facts seem to prove that this is false, as long as we act on the basic hypothesis of “a serious market imperfection”.

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[37] India Microfinance, http://www.indiamicrofinance.com/2009/03/pakistan-farmers-accuse-mfis-of.html

[38] See on Micro Capital site : Yunus Speaks Out Against For-Profit Microfinance – Aug08 http://www.microcapital.org/microcapital-story-nobel-laureate-muhammad-yunus-speaks-out-against-for-profit-microfinance-from-asia-pacific-microcredit-summit/

[39] Chuck Waterfield : “Understanding annual percentage rate (APRs)” – 28 Sept 08 http://www.mftransparency.org/media/pdf/UnderstandingARPs.pdf

These supposed "imperfections" act as if they constituted the only reference of the reasoning. Implicitly, these references mean: if the market worked better, if we could go closer to this "perfection", everything would work better.

But this reference does not function. Prices result from a balance of power more than from markets rules. In an interview with Street.com, Waterfield commented on the very high interest rates: "It's not a market rate, it's a what-a-market-can-bear rate". This means that the lender wants the highest possible rates, until the customers prove they are unable to pay back in good conditions.

This means that the ideal of a "loyal competition" is not effective in MF. For many reasons, competition doesn't function in this sector; thus price definition won't depend on the "market price", that would result from this competition, but from the balance of power that the customers succeed (or not) in building into their relations with the lenders.

4. The "free market" MF is a part of a specific conception of entrepreneurship

The excessive costs of MF for the poor are the result of a long, convergent evolution. Other fields of academic research had a determining influence in the area. This can be demonstrated with three authors, or three symbolic research projects.

But the criticism that follows does not primarily concern the quality of this research, but rather the way it is interpreted, when used by policy makers.

4.1. To establish property rights for the poor, so they can use property as collateral for borrowing.

Hernando de Soto has being asking the poor countries for decades to reform their systems of individual property[40]. The poor are indeed "owners" of houses, but within an informal economy. Thus, this legal insecurity does not allow them to use these properties as collateral, on the model of the American mortgage loan. Thus the public authorities have to guarantee the effectiveness of these rights, so they can be proposed by poor people as mortgage.

However, the impact of such reforms is not limited only to establishing new property rights in the formal economy. The other impact is to guarantee to the lenders that the poor, once they are holders of property rights, can be sued in case of incident in the repayment of a loan.

In "Removing obstacles to Growth, the overview year", the World Bank quotes clearly De Soto: "Heavy regulation and weak property rights exclude the poor from doing business (…). In The Mystery of Capital, Hernando de Soto exposed the damaging effects of heavy business regulation and weak property rights. With burdensome entry regulations, few businesses bother to register. Instead, they choose to operate in the informal economy. Facing high deal

[40] Hernando De Soto. *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. Basic Books, 2000

costs to get formal property titles, many would-be entrepreneurs own informal assets that cannot be used as collateral to obtain loans."

But the interpretation by the World Bank can be the reverse. Improving property titles is efficient for the poor; and also for lenders and foreign investors, to secure their loans.

In Nicaragua, recent MF customers' revolts (Summer, 2008) were directly connected to the fact that the customers in trouble, who had given their homes as collateral, were expropriated by their lenders at the first repayment incident. While the origin of the loan is in a new business, the risk of the loan includes the risk of losing one's essential possession –one's home. This is a disproportionate stake.

In most of the Western countries (for instance in France), it is forbidden to the lender to take the home of the borrower as a collateral. The disparity of the conditions in the contract is recognized by the law, which protects the customer against his/her own carelessness.

4.2. Develop marketing that targets the poor as creative, entrepreneurial people, and eager to consume: the fortune at the base of the pyramid

The works of C.K. Prahalad had a real influence in the United States on the big companies' strategies towards the poor. The book nevertheless is based on a sophism that his author tried to correct afterwards.

The idea is that the poor, with a reduced purchasing power, nevertheless have the possibility of consuming if they are being proposed attractive products, but in small quantity; or in weak unit costs which correspond to their short-term budgets. However, a posteriori, the forecasts linked with this strategy seem hardly operational. Four billion poor persons would represent a 5,000 billion dollar market, says a report released by IFC, the private sector arm of the World Bank Group, and World Resources Institute in 2007[41].

The criticism of this type of analysis is about the confusion in considering the poor as consumers, or as producers, who need above all to finance their production. This is the argument of Prof. Aneel Karnani: « Rather than focusing on the poor as consumers, we need to view the poor as producers. The only way to alleviate poverty is to raise the real income of the poor"[42].

The fact is that motivation for entrepreneurship in the developing world is often for survival, not really a "business opportunity". The point is made in the Global Entrepreneurship Monitor in 2006[43] that "early-stage entrepreneurial activity is generally higher in those countries with lower levels of GDP" - because a lot of people in the developing world "are pushed into entrepreneurship as all other options for work are either absent or unsatisfactory ("necessity entrepreneurs")."

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[41] *From The World Resources Institute www.wri.org ;*
Quoted in http://www.socialfunds.com/news/release.cgi/7867.html

[42] Karnani, Aneel G., "Fortune at the Bottom of the Pyramid: A Mirage" (July 2006). Ross School of Business University of Michigan Paper No. 1035 Available at SSRN: http://ssrn.com/abstract=914518
Ross School of Business Paper No. 1035

[43] http://www.gemconsortium.org/about.aspx?page=global_reports_2006

4.3. The criteria of the Doing Business surveys applied to the poor countries are more interesting for investors than for entrepreneurs

The annual *Doing Business* survey is considered today as the indispensable guide for the reforms to be introduced into all the countries, in order to make them more entrepreneurial. The indicators are taken into account in the decisions of the World Bank, and its financial satellites including the CGAP, and the big banks.

But some of the criteria used to rate countries are much more interesting for outside investors than for local entrepreneurs. For instance, dealing with licences, employing workers, protecting investors; paying tax, enforcing contracts, closing a business … All these criteria can be used to raise competition between different countries to set up new businesses, or displace an existing one.

Critics of these forecasts are introduced by researchers in various disciplines to discuss the validity of *Doing Business*: on the narrow limits of the interpretation of the results[44]; on the effectiveness of the Anglo-Saxon common law; including its historic interpretation[45]; on the comparability of the criteria[46]…

4.4. The individualization of loans, after the period of group loans, confirms this tendency

The systematic transition from group loans to individual loans in all the big MFIs has as a consequence the creation of very sophisticated information systems for the benefit of the lenders. This tendency results today in recommending the creation of credit bureaus: "Finally, we find that legal origins are an important determinant of both creditor rights and information sharing institutions. The analysis suggests that public credit registries, which are primarily a feature of French civil law countries, benefit private credit markets in developing countries"[47].

But nothing is said on the controls by the public authorities of these credit registers; notably on the respect of personal freedom, as a lot of personal information is collected without the customers having the right to correct it.

[44] « Doing Business : une évaluation indépendante - Les indicateurs Doing Business de la Banque mondiale–IFC passés au crible »
[45] Claire Lemercier : « Napoléon contre la croissance ? - À propos de droit, d'économie et d'histoire » Ed La Vie des Idées, 2009
[46] Kevin E. Davis and Michael B. Kruse : "Taking the Measure of Law The Case of the Doing Business Project"
[47] Simeon Djankov, Caralee McLiesh, and Andrei Shleifer : « Private Credit in 129 Countries - Final Draft », March 2006

4.5 The current tendency of the "free market MF": confer all the risks upon the customers

The "free market MF" thus works based on a contractual fiction. The customers are supposed to be perfectly informed about the offers made to them; and thus accept them by assuming all the responsibilities and all the risks of the loan agreement. Even if the risks include losing their home, although it has nothing to do with the purpose of the loan contract.

5. MF as a part of a development policy, not as a pure market transaction

At the very beginning, MF was conceived as operating outside market rules, because it gave poor people who were not served by the market operators access to financial resources.

Subsequently, the "advice" from CGAP to the big investors consisted of fixing very "free market" intervention criteria in the MFIs. Financial autonomy became essential: "the objective is to reduce firmly the dependence (of the MFI) on subsidies and aim towards financial sustainability". The results would be certain: "International experiments show that the best MFIs reached their operational efficiency in 3 - 7 years; and their financial sustainability (…) in 5 - 10 years"[48].

Other experts, who use tools other than CGAP, do not believe in these forecasts. The International Labour Office team, steered by Bernd Balkenhol, reaches very different results; and especially asserts that MF has to join public development policies[49]. With microfinance, one only creates micro-development. Microfinance does not build health systems, education systems or housing policies.

Furthermore, surveys prove that there is a link between the aim of financial sustainability and the type of target clients. In summary, the MFIs which look for profit above all are also those who address the "not-so-poor", the least poor among the poor: those who already live in financial autonomy and have the capacity to develop their own businesses (such as small urban craftsmen whose activity is on the way to formalization).

[48] See the « Donor Guidelines for Microfinance International Best Practice », from the Committee of Donor Agencies for Small Enterprise Development. On the site of FENU- UNCDF, United Nations Fund

[49] See a summary of MF and public policies: http://www.lamicrofinance.org/content/article/detail/20988?PHPSESSID=25ddc55a10937b50926f5d5e6c07c799

5.1. There is no solid correlation between the maximum profitability and the social performances of MF

We will probably soon be able to demonstrate that the search for maximum profit of certain MFIs does not allow them to produce acceptable social performances. The work h by Sayed Hashemi from CGAP to create a consensus on measuring social performances has shown results[50]. This information is going to be collected, and made homogeneous. The MIX Market, the only source of information about MFIs, agreed to integrate such information into its data base; it will begin to be available in 2010[51]. The results will be different, depending on what segment of the "market" is analysed. But most probably, the high interest rates of microloans do not allow poor people to create new assets: a large part of added value is captured by the lender.

5.1.1. Only "soft regulation" against abuses?

The first initiative against abuses in MF was set up by Muhamad Yunus and Chuck Waterfiel in creating MF Transparency in 2008[52]. But this organisation is only focused on improving information on interest rates. Joining this organisation does not create any obligation to lower, or even change the practices of MFIs. As an example, Compartamos joined this network.

The second initiative set up at the beginning of 2009 is on client protection[53]. It seems to demonstrate that it is urgent to build barriers against abuses. Accion international, which is taking the initiative, was one of the biggest shareholders of Compartamos. The first statement from the Steering committee says that "Competition, the desire to achieve profitability, and internal-sales incentives may all play a role in pushing financial institutions into practices that are not consistent with pro-consumer ideals". So "there is a strong need for the industry to ensure that providers take steps to protect low-income clients from potentially harmful financial products and ensure that they are treated fairly".

But in both of these initiatives, there are only private rules (or principles) proposed to the industry, without any enforcement by the law. This is a sort of rule inside the MF industry: we have nothing to do with Governments, particularly from southern countries…

The fact is that "soft regulation" in financial markets demonstrated its inefficiency, at the beginning of the current financial meltdown!

[50] Nowadays, SPTF, Social performance task force, is representing this consensus. See http://www.lamicrofinance.org/content/article/detail/19968

[51] A questionnaire was sent to 1,300 MFIs in March 2009. See http://microfinancegateway.org/content/article/detail/56418

[52] See : http://www.mftransparency.org/

[53] See on Microfinance Gateway: "International Steering Committee Endorses Six Principles of Client Protection in Microfinance". http://www.microfinancegateway.org/content/article/detail/56394

5.2. More widely, MF outside the constraints of the market should be included in overall development policies

Dani Rodrick, professor at Harvard and one of the most respected economists in the development field, has shown that the objectives of liberalization, privatization and external opening (to which the "good governance" was added), lead to unambiguous economic and institutional recommendations. As Rodrick shows, India knew an economic take-off in the 1980s, around ten years before the implementation of economic policies inspired by the "Washington consensus". According to Rodrik, this example illustrates the success of policies favorable to business (pro-business), compared to policies favorable to the market (pro-market).

More recently, he used[54] very new calculations[55] to show that the more open a country is towards the outside, the weaker the weight of public spending is there. In summary, this opening destroys the means of protection, because the competition becomes frontal, and concerns first and foremost the most fragile sectors: "Economic theory and intuition suggest that as economies become more globalized, the ability of governments to undertake redistributive policies and to engage in social spending erodes. After all, a large part of the tax base - corporations, financial intermediaries, and skilled workers in particular - become internationally mobile and can evade taxes needed to finance those public expenditures ".

6. Conclusion on entrepreneurship

Entrepreneurship could be conceived as one of the elements of local development. The creation of wealth by the entrepreneurs benefits the whole community, and creates collective dynamics that concern education and transmission of new values within the community.

This justifies the treatment, outside the "market laws", of a part of the development tools, including financial ones; even if the resources of Southern countries are not comparable with those of developed countries.

[54] Dani Rodrick : "Does globalization erode social safety nets?" http://rodrik.typepad.com/dani_rodriks_weblog/2008/12/does-globalization-erode-social-safety-nets.html
[55] From a survey by Giuseppe Bertola and Anna Lo Prete : new evidence

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