

Marchese, M. (2014), "Entrepreneurial Activities in Europe - Finance for Inclusive Entrepreneurship", *OECD Employment Policy Papers*, No. 5, OECD Publishing, Paris.
<http://dx.doi.org/10.1787/5jxrcmkgkzzs-en>



OECD Employment Policy Papers No. 5

Entrepreneurial Activities in Europe - Finance for Inclusive Entrepreneurship

Marco Marchese

ENTREPRENEURIAL ACTIVITIES IN EUROPE

FINANCE FOR INCLUSIVE ENTREPRENEURSHIP

OECD EMPLOYMENT POLICY PAPER

April 2014 **No. 5**



Policy Brief on Access to Business Start-up Finance for Inclusive Entrepreneurship

Entrepreneurial Activities in Europe



This paper is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and the arguments employed herein do not necessarily reflect the official views of OECD member countries or those of the European Union.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Authorised for publication by Sergio Arzeni, Director, Centre for Entrepreneurship, SMEs, Tourism and Local Development.

Acknowledgements

This paper was drafted by Marco Marchese under the direction of Jonathan Potter, both of the Local Economic and Employment Development Division of the Organisation for Economic Co-operation and Development. This paper is part of a series of policy briefs on inclusive entrepreneurship produced by the OECD Local Economic and Employment Development Programme and the European Commission Directorate General for Employment, Social Affairs and Inclusion. This work is led by Jonathan Potter and David Halabisky of the OECD.

© Cover photo: Belga Image

For any use or reproduction of photos which are not under OECD/European Union copyright, permission must be sought directly from the copyright holder(s).

*Europe Direct is a service to help you find answers
to your questions about the European Union*

Freephone number (*):
00 800 6 7 8 9 10 11

(*) The information given is free, as are most calls
(though some operators, phone boxes or hotels may charge you).

More information on the European Union is available on the Internet (<http://europa.eu>). More information on the OECD is available on the internet (<http://www.oecd.org>).

Cataloguing data as well as an abstract can be found at the end of this publication.
Luxembourg: Publications Office of the European Union, 2014

European Commission
ISBN 978-92-79-33516-7

© OECD/European Union, 2014
Reproduction is authorised provided the source is acknowledged.

Policy Brief on Access to Business Start-up Finance for Inclusive Entrepreneurship

Entrepreneurial Activities in Europe

■ CONTENTS

KEY MESSAGES	3
INTRODUCTION.....	3
THE SCALE AND NATURE OF THE FINANCING CHALLENGE	4
External finance as a start-up barrier	4
Sources of start-up finance.....	5
The use of start-up loans across countries	6
Market exit due to problems in obtaining finance.....	7
BARRIERS TO OBTAINING FINANCE FOR DISADVANTAGED AND UNDER-REPRESENTED GROUPS IN ENTREPRENEURSHIP	10
TRADITIONAL POLICIES FOR FINANCING BUSINESS START-UP BY EXCLUDED GROUPS	10
Grants and income subsidies	11
Soft loans	11
NEW AND EMERGING POLICY ACTIONS FOR FINANCING BUSINESS START-UPS IN SOCIAL INCLUSION TARGET GROUPS	12
Loan guarantees.....	12
Microcredit	14
Alternative debt finance.....	16
Crowdfunding	17
Peer-to-peer lending	18
Business angels	18
Islamic finance	19
Self-financing groups	21
THE ROLE OF FINANCIAL EDUCATION	21
CONCLUSIONS	23
GLOSSARY	25
FURTHER READING	25
BIBLIOGRAPHY	26

KEY MESSAGES

- People disadvantaged in the labour market or underrepresented in the entrepreneurial population are disproportionately impacted by difficulties in access to finance for business start-ups. Low-educated and young people, in particular, are more likely to mention financing problems as a major constraint to starting a business. Women and young entrepreneurs rely more on the support of family, friends and public authorities. The low educated, on the other hand, are less likely to receive public financing.
- Traditional financing mechanisms such as grants and subsidised loans have supported in the past the self-employment of disadvantaged groups. However, given the current constraints to government budgets, they are expensive policy solutions. New emerging financing instruments can complement the role of traditional policies, including loan guarantees, microcredit, crowdfunding, peer-to-peer lending and business angel investment. It is important that policy makers introduce appropriate policy actions to extend the reach of these mechanisms.
- Loan guarantees have mainly been used so far by traditional small firms, but they can also play a role in supporting inclusive entrepreneurship. Targeted microcredit programmes are warranted to make microcredit more socially inclusive, as there are signs that microcredit in the EU might not be serving adequately the needs of traditional clients such as women and migrants. Awareness should be raised and appropriate regulations introduced to support Internet-based mechanisms such as crowdfunding and peer-to-peer lending. Business angel investment, while traditionally associated with high-impact entrepreneurship, can also positively affect the development of inclusive entrepreneurship, provided that appropriate adjustments are adopted.
- Barriers to access to finance are not only of market nature. Supply-side interventions should be integrated by others aimed at upgrading the skills of disadvantaged entrepreneurs, including financial education. Financial education must be practice-oriented and is most likely to have an impact if its provision is integrated with the supply of finance.

■ INTRODUCTION

More than one-third of the European Union's adult population would rather be self-employed than an employee if given the chance to choose, according to the 2012 Flash Eurobarometer survey. At the same time, there is a large entrepreneurial potential in social groups that are either disadvantaged in the labour market (e.g. youth, migrants, and the low-skilled) or underrepresented in the entrepreneurial population (e.g. women and seniors). Inclusive entrepreneurship policies aim to give the opportunity for people from these groups to start-up in business and self-employment both for economic reasons and to support the goal of social inclusion.

One of the critical areas for policy action involves improving access to finance. Lack of finance is a common barrier for most new enterprises, which is magnified among the most disadvantaged and under-represented groups (with the exception of senior entrepreneurs), reflecting in large part the relative lack of collateral assets and own financial resources in these groups. Some of these groups may additionally face social discrimination in credit markets. Policies and programmes that favour access to finance for disadvantaged or underrepresented entrepreneurs have, therefore, both a social and economic dimension. They help beneficiaries to integrate in the labour market through an income-generating activity either in the form of a start-up or through increased employability. The ultimate goal of interventions should be that everyone, irrespective of sex, age or ethnic background, has access to business financing tools available in the market.

Inclusive financing programmes should be flexible to accommodate for the different, sometimes unconventional, types of

business that disadvantaged entrepreneurs run. Women may start a business and strive to reconcile work and family, thus spending less time at work than the average entrepreneur. They may also need to run a business from home, something which also applies to entrepreneurs with physical disabilities. Migrants often combine different activities together to guarantee their livelihood, with the physical and legal boundaries between different activities not always clear. Financing schemes for inclusive entrepreneurship should adapt to these peculiarities because they reflect some of the barriers that prevent female, disabled and migrant entrepreneurs from access to traditional sources of enterprise finance.

New sets of finance products have emerged in the market that can serve the needs of disadvantaged entrepreneurs. This policy brief focuses on these new tools, which offer a more sustainable approach than traditional grants to finance inclusive entrepreneurship. Some of these instruments (e.g. crowdfunding and peer-to-peer lending) use the power of the Internet to shorten the distance between lenders and borrowers and wipe out possible discrimination effects. Others (e.g. loan guarantees, microcredit, alternative debt finance, and business angels) address market failures that are more likely to affect entrepreneurs from disadvantaged groups. Still others by-pass the market to rely on forms of self-support (e.g. self-financing groups) or try to dovetail market rules with moral principles (e.g. Islamic finance). Supply-side interventions need to be combined with financial education to improve the financial literacy skills of disadvantaged entrepreneurs. In the case of our target groups, barriers to access to finance are in fact not

only of market nature, but also involve limited understanding of the credit market (e.g. loan application process, interest rates, time value of money, etc.).

The policy brief proceeds as follow. First, data on access to finance by women, young and low-educated entrepreneurs are presented to give an overview of the challenge facing policy makers who want to promote access to finance for

disadvantaged entrepreneurs. Second, the main types of barriers in access to finance for these target groups are discussed. Third, policies to finance inclusive entrepreneurship are discussed at length. The focus is mainly on emerging mechanisms, with an emphasis also on operational aspects that can help policy makers to introduce these schemes. Conclusions restate the main findings and policy recommendations of the brief.

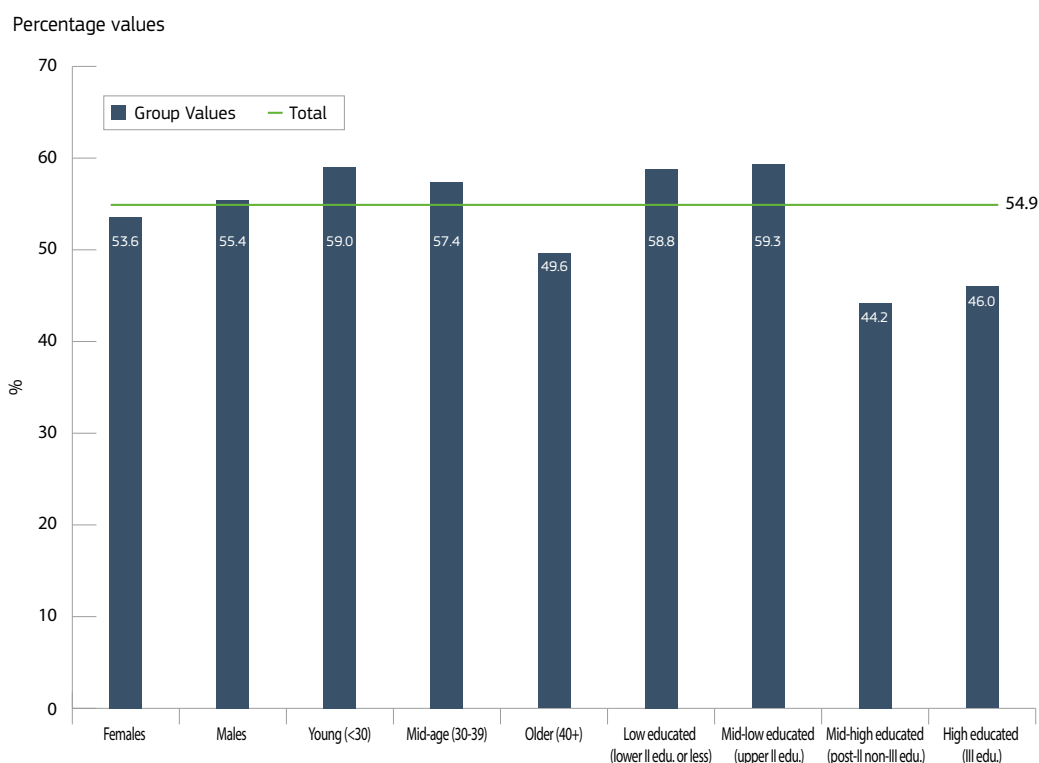
■ THE SCALE AND NATURE OF THE FINANCING CHALLENGE

External finance as a start-up barrier

Survey evidence from across the European Union indicates that obtaining external finance is a major barrier to business start-up across all socio-demographic groups (Figure 1).⁽¹⁾ More than one-half of new entrepreneurs across all groups consider obtaining finance to be an important problem, the only exceptions being entrepreneurs aged above 40 and those with post-secondary education. The low-educated and young entrepreneurs have the greatest problems in this respect. More men than women entrepreneurs report obtaining financing as

having been a major problem in the start-up phase, although the difference is minimal. This possibly reflects the nature of the enterprises women tend to start. Women entrepreneurs are disproportionally present in the services sector, which has lower entry costs, and are more likely to start a business driven by the need to combine family and work (OECD, 2012). Thus, women entrepreneurs have lower financial needs on average than male entrepreneurs. On the other hand, there is evidence of undercapitalisation of many women-owned businesses, and greater reliance on bootstrapping and short-term loans, which tend to increase vulnerability to bankruptcy (OECD, 2012).⁽²⁾

Figure 1. Percentage of entrepreneurs reporting 'obtaining finance' as a major start-up difficulty in 15 EU countries, 2005



Source: OECD based on EUROSTAT FOBS, 2005.

⁽¹⁾ One of the best sources of data on access to finance by socio-demographic groups is the EUROSTAT Factors of Business Success (FOBS) survey, which was unfortunately conducted only in 2005 on business founders from 15 EU countries participating on a voluntary basis. The survey covered enterprises born in 2002, that had survived to 2005, and that were still managed by the founder at the time of the survey. It covered Austria, Bulgaria, Czech Republic, Denmark, Estonia, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Romania, Slovakia, Slovenia and Sweden. Dating back to 2005, the survey does not take into account the consequences of the global economic crisis (2008) and of the largest EU enlargement to Eastern Europe (2004).

⁽²⁾ Bootstrapping can be defined as the use of internal sources to meet the resource needs of a business without relying on external finance. This includes minimisation of accounts receivable, joint utilisation of machinery, delaying payments, and minimisation of capital invested in stocks.

Sources of start-up finance

Figure 2 shows the main sources of finance used for business start-up across different socio-demographic groups. The 3Fs of founder, family and friends are the main source of start-up finance for all groups. However, thanks to greater savings or possibly greater risk propensity, male, older and higher-educated entrepreneurs are more likely than others to draw on their own personal resources to set up a business activity. This is confirmed by a country-based examination of “nascent entrepreneurs” (Figure 3),⁽³⁾ which shows how in most EU countries senior nascent entrepreneurs are more likely than junior nascent entrepreneurs to expect financing their business without any external contribution. The median value for nascent entrepreneurs that foresee to fully self-finance their business is 53% for senior entrepreneurs (Italy), but only 38% for young entrepreneurs (Slovenia). With respect to women and low-educated entrepreneurs, the median value stands respectively at 51% (Finland) and 45% (Greece). Given the overwhelming role that personal resources play in the financing of start-ups, this enables men and older people to get more easily involved in entrepreneurship and develop sturdier businesses. At the same time, this signals a problem for other groups, which tend to be forced to make greater use of “financial assistance from family and friends”. Women and young people and, to a lesser extent, low-educated entrepreneurs, are more likely than others to resort to this source of start-up finance (Figure 2).

Apart from use of own funds and funds from family and friends, the main sources of funding are bank loans, public authorities, capital contributions from other enterprises and venture capital

(Figure 2). Access to these sources can be vital to the ability of entrepreneurs to make the necessary start-up investments and to cover operating costs until revenues flow in. However, there are important differences across socio-demographic groups in their abilities to access external funding sources.

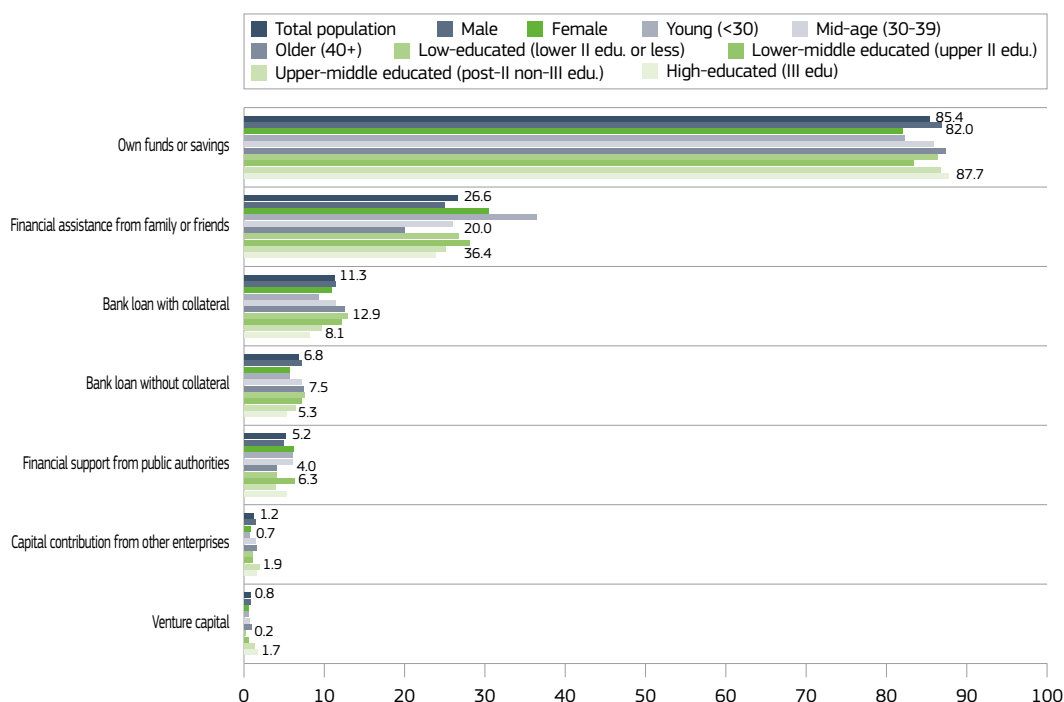
For example, male entrepreneurs are more likely than female entrepreneurs to use bank loans to fuel the start-up process. Interestingly, the gender gap is bigger for uncollateralised loans than for collateralised loans. On the other hand, the level of education is not a strong determinant of access to loans. Business founders with primary and lower secondary education are those more likely to have used both uncollateralised and collateralised loans to launch an enterprise.

Other financial sources are less important on average. However, public financial support has made a contribution to business start-up by a significant group of entrepreneurs. Women and youth are the categories of entrepreneurs most likely to be targeted by public financial support. Results on levels of education are again not as straightforward as for sex and age, with entrepreneurs with upper secondary and tertiary education more likely to receive financial aid. One explanation could lie in the better ability of higher-educated entrepreneurs to disentangle themselves in the twists and turns of the bureaucracy involving access to public financial support.

“Access to venture capital” gives very similar results. Male, senior and higher-educated entrepreneurs report considerably more often than the others the use of venture capital to set out a business, although the percentages remain small across all social groups.

Figure 2. Sources of start-up finance across socio-demographic groups in 15 EU countries, 2005

Percentage of entrepreneurs using specific sources of finance for business start-ups (multiple answers possible)



Source: OECD based on EUROSTAT FOBS, 2005.

⁽³⁾ Based on the definition of the Global Entrepreneurship Monitor report, nascent entrepreneurs are people actively involved in setting up a business they will own or co-own.

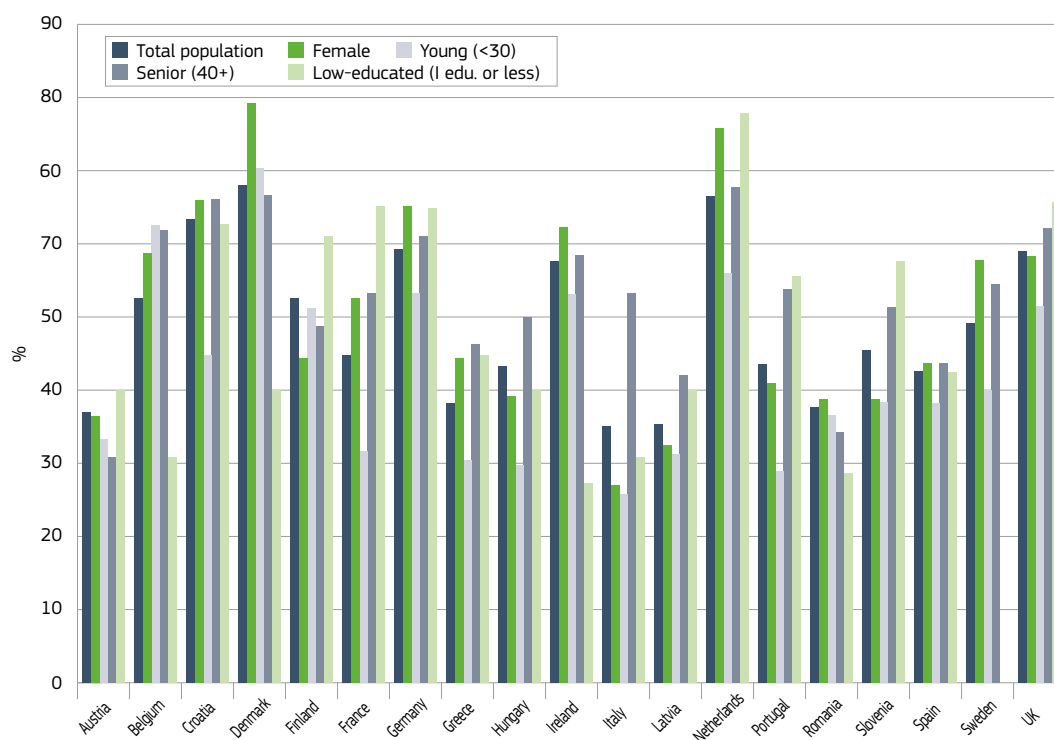
Figure 3 looks at the financing issue from another point of view, namely the proportion of people who fully self-finance their business start. The graph shows that a substantial minority of people start up their business using entirely their own funding in all countries, but that self-funding tends to be higher in certain countries like the Netherlands and Denmark than others such as Austria, Latvia and Romania. However, the interpretation is complicated by the fact that two separate issues are likely to be in play. On the one hand, people with substantial own resources may decide to finance themselves rather than seek external finance. On the other hand, people who are refused external finance, or are discouraged from seeking it, will be forced to use their own resources even though

this may constrain the development of their business. In terms of specific target groups, seniors used self-financing more than youth in fourteen of the nineteen countries. This is likely to reflect the greater resources available to seniors. In northern European economies such as Denmark, Netherlands, Germany, and Sweden, a very large proportion of women fully self-finance their business start-up, which may be the result either of sufficient personal savings or of lower capital needs required by the business they set out (e.g. part time business or in low-cost services), whereas in eastern and southern European countries the proportion of self-sufficient women entrepreneurs is lower, pointing to limited personal savings possibly due to lower participation in the labour market.

Figure 3. Self-financed nascent entrepreneurs across socio-demographic groups in selected EU countries, 2007-2010



Proportion of nascent entrepreneurs who expect to fully self-finance their business start-up



Source: OECD based on GEM (Global Entrepreneurship Monitor) database.

Note: Years from 2007 to 2010 have been pooled due to limited number of observations on single years.

The use of start-up loans across countries

The Figure 4 shows that there are some significant differences in the use of start-up loans by entrepreneurs from disadvantaged and under-represented groups. The highest proportions of loan beneficiaries are in Denmark and Austria, where the percentages of women, youth and low-educated people receiving bank loans to set out an enterprise were much higher than those in, for example, the Czech Republic, Romania and Slovakia.

Wide national differences point to the importance of targeted approaches to financing inclusive entrepreneurship. Since Eastern Europe does worse than Western Europe, there is scope for using the European Social Fund to make strides in strengthening inclusive entrepreneurship. It may well be possible that within-country

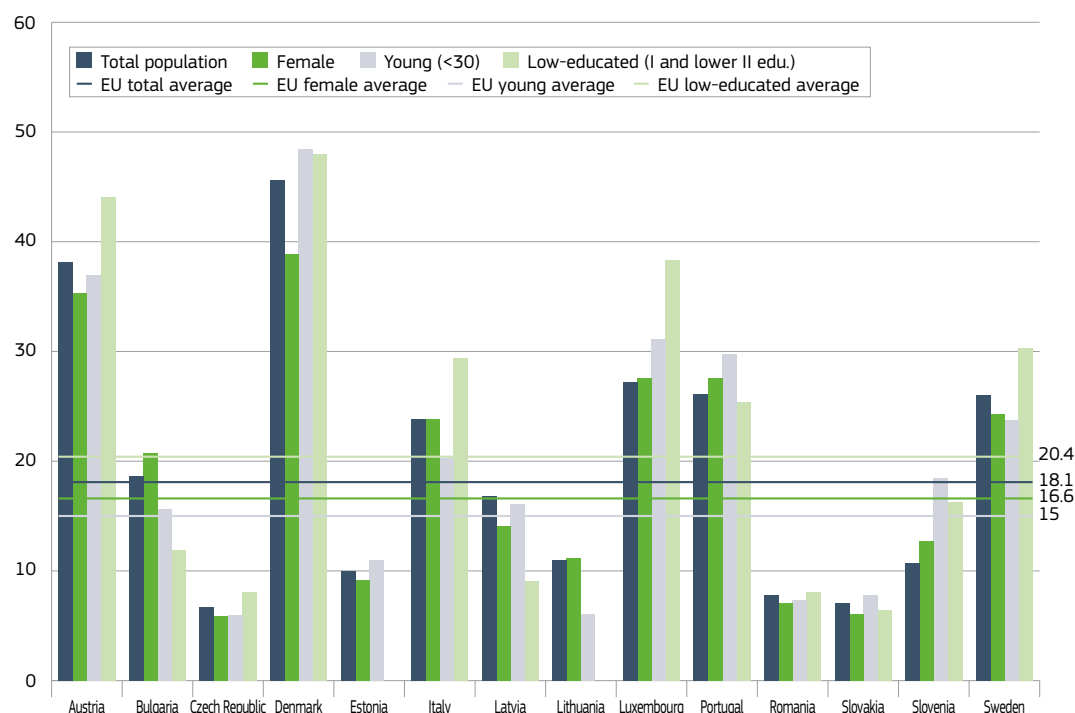
differences are deeper than cross-country ones, which would suggest the need for a place-based approach where regional authorities design bespoke programmes to enhance access to finance by social target groups and where national programmes are flexible enough to be tailored to different local economic contexts.

EU western countries should also take action. National comparative data on resort to start-up loans would show that women, young, and low-educated entrepreneurs perform worse than male, senior and high-educated entrepreneurs also in the west of the EU (Austria, Denmark, Italy, Luxembourg, Portugal and Sweden). In fact, across the whole range of FOBS-surveyed countries, the biggest gender gap (47.3% for men vs. 38.9% for women) and the biggest age gap (28.8% for senior vs. 20.3% for young) were respectively found in Denmark and Italy.

Figure 4. Use of bank start-up loans by groups across selected EU countries, 2005



Percentage of respondents using bank loans for starting up a business



Source: OECD based on EUROSTAT FOBS, 2005.

Market exit due to problems in obtaining finance

Problems in obtaining external finance are one of the possible reasons for entrepreneurs to exit the market. Its importance has increased following the 2008 global economic crisis and the 2011 sovereign debt crisis that have resulted in a credit crunch forcing many entrepreneurs to shut down their business (see Box 2). Figure 5, based on Global Entrepreneurship Monitor (GEM) data, confirms, but to a lower extent, the divide between Eastern and Western Europe with respect to access to finance for disadvantaged entrepreneurs. Since GEM data are more recent than FOBS data, this might signal that the east-west gap is being bridged.

With respect to gender, Hungary is the country where the highest share of women ex-entrepreneurs reports problems in obtaining finance as having been the most important reason for exit (40.2%), although the proportion for men is also high (37.4%).⁽⁴⁾ Best performers are Sweden and the UK, where only 1.9% and 3.6% of female respondents mentioned lack of external finance as the main reason to close their business. Positive situations are also found in Eastern Europe. The Czech Republic and Slovakia, for example, do better than France, Spain or Belgium.

Within-country gaps are also important. In the case of gender, women are less likely to search for external finance and are

therefore expected to report less than men lack of finance as the most important reason for business exit. GEM data confirm this assumption and show that in most countries male entrepreneurs are more likely than female entrepreneurs to report problems in obtaining finance as the main reason for business closure. Countries with the biggest gender gap (i.e. women showing higher rates) are Estonia (above 5 percentage points) and Hungary (nearly 3 percentage points).

The age variable confirms that some eastern European countries have made strides in providing disadvantaged entrepreneurs with better access to credit. After the UK (7%), Slovakia (7.8%) and Poland (9.1%) are the countries where the smallest proportions of young ex-entrepreneurs (aged 18–29) report lack of finance as the main reason to have closed their business. Slovenia (34.6%) and the Netherlands (31.8%) are the countries where the highest percentages of young entrepreneurs have decided to exit the market due to lack of finance. The two are also the countries where the highest within-country gaps between young and older entrepreneurs (aged 40–64) are observed: 25.8 percentage points in the Netherlands and 17.4 percentage points in Slovenia.

The east-west divide in the EU is stronger when one looks at reasons for exit among low-educated entrepreneurs (primary degree or less), although Croatia and Slovakia are exceptions. As much as 50% of Latvian and 46.8% of Hungarian low-educated entrepreneurs have exited the market mainly due to problems in obtaining finance, while the corresponding proportion is as low as 3% and 5% in Finland and Ireland. Within-country education gaps show that the low-educated face comparatively worse

⁽⁴⁾ The perception of a generally tight credit market in Hungary is corroborated also by the other socio-demographic variables taken into consideration in this section.

conditions in Eastern Europe. The gap between the proportion of low-educated and high-educated (post-secondary degree) ex-entrepreneurs who report lack of external finance as the principal motivation to have closed their business is 27.9 percentage points in Latvia and 13.6 percentage points in Poland. In some countries such as Spain and France, however, the trend is reversed, thus confirming that the entrepreneur's level of education is not always a strong determinant of access to finance.

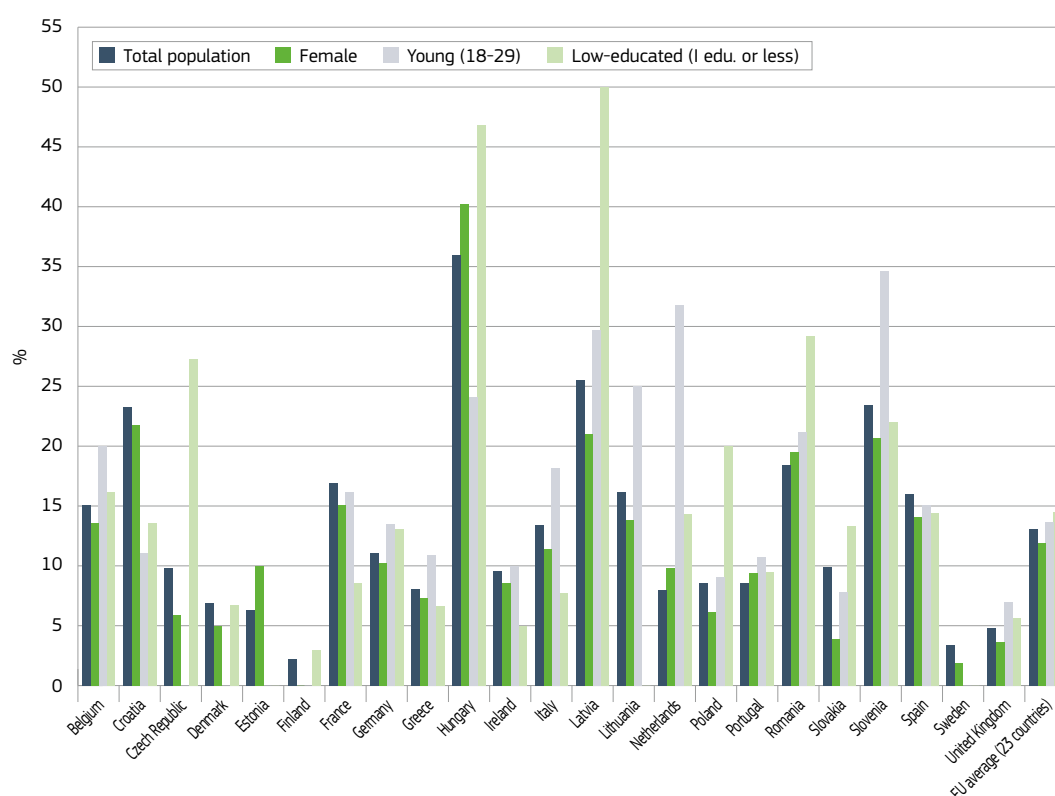
To wrap up, there is much heterogeneity across countries and socio-demographic groups. Some countries in Eastern Europe

do better than others in the region or even in Western Europe. However, low-educated entrepreneurs are still faced with generally adverse conditions in most of Eastern Europe. This signals a policy priority area for the entire region. In Western Europe the group that needs most attention is the youth. The situation is very negative in the Netherlands, possibly because of the effects of the crisis, but large countries such as France, Italy and Spain also see the youth at a disadvantage when looking for finance to save their business. On the other hand, in these countries low-educated entrepreneurs are not more likely than high-educated entrepreneurs to report lack of finance as the main reason to close their business.

Figure 5. Problems in obtaining finance as the most important reason for business exit across selected EU countries, 2008-2012



Percentage of former entrepreneurs who report problems in obtaining finance as the most important reason for closing the business



Source: OECD based on GEM (Global Entrepreneurship Monitor) Database, 2012.

Notes: Years from 2008 to 2012 have been pooled due to limited number of observations on single years.

EU average is not weighted by country population.

Box 1 The impact of the crisis and new banking regulations

The economic crisis has dragged on in Europe since 2008, firstly through the failure and retrenchment of financial institutions and then because of the sovereign debt crisis. The crisis has had a severe impact on small business financing. Loan rejections at EU-27 aggregate level rose from 12% to 18% between the first and second half of 2009 and then fell back to 11% in 2010 and 2011. Loan terms for small firms also worsened comparatively to large firms, and the interest rate spread between SMEs and large enterprises widened (OECD, 2012).

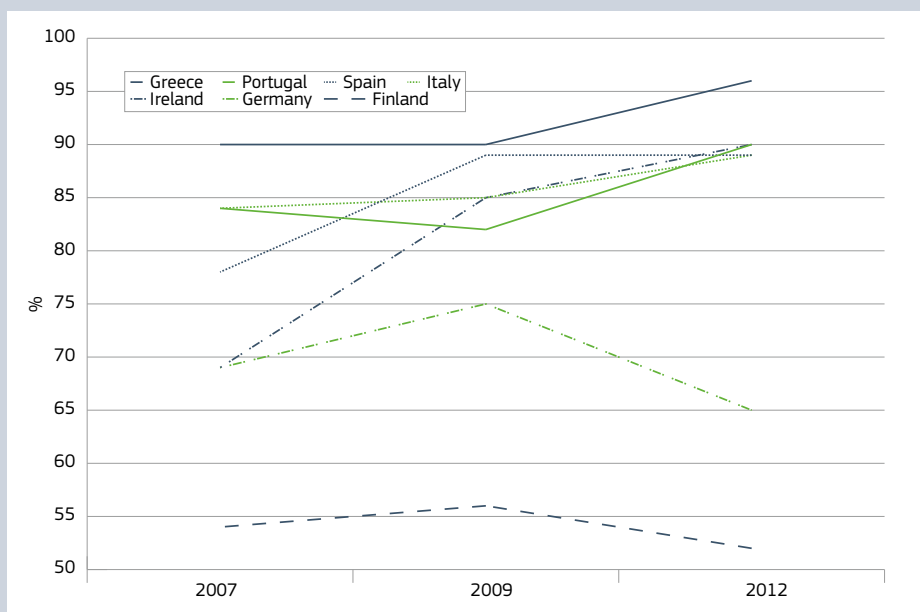
The crisis has had a disproportionate impact on SMEs in southern Europe and Ireland. Between 2007 and 2010 there was a drop in fully successful loan applications by SMEs from 97% to 53% in Ireland, from 87% to 59% in Spain and from 88% to 60% in Greece (Eurostat, 2011). The outbreak of the sovereign debt crisis in summer 2011 is likely to have made access to SME loans even more difficult, and SMEs in Greece, Portugal and Italy reported strong increases in their need for bank loans over the period from October 2012 to March 2013 (ECB, 2013).

In addition to suffering a credit crunch, SMEs in southern Europe and Ireland have also experienced a deterioration of credit conditions. Between 2010 and 2011, both the average SME interest rate and the interest rate spread between loans for SMEs and loans for large firms increased in Ireland, Spain and Italy. In Portugal, the interest rate spread marginally decreased only because the average interest rate for large companies augmented comparatively more than the average SME interest rate, which nonetheless rose by over 1% (OECD, forthcoming).

The crisis also seems to be having an impact on the inflow of new entrepreneurs. The Flash Eurobarometer surveys show that lack of available financial support was considered a difficulty to business start-up by 79% of EU-27 respondents in 2012, 4 percentage points higher than in 2007 (75%), although this had dropped by 2 percentage points from the peak in 2009 (81%). The biggest toll on entrepreneurship activity appears to be in those countries hit hardest by the crisis (Greece, Ireland, Italy, Spain and Portugal), while others (Germany and Finland) have advanced well along the road to recovery.

Figure 6. Lack of financial support is a barrier to start-up

Percentage of respondents who agree



Source: OECD based on EC, 2010 and 2013a.

Banking reforms are to be introduced across Europe in the form of minimum capital requirements and liquidity management – commonly known as Basel III – which could have an impact on access to debt finance for new start-up enterprises. While the entire reform will become fully operational only in 2019 and it cannot be predicted how banks will react to increased capital requirements, there are two issues which will need to be monitored.

First, the banks' ratio of core Tier-1 capital (common equity and retained earnings) to risk-weighted assets will increase from 2% to 7%, with a counter-cyclical buffer of 0%-2.5% that can be added at a national level if the country's macroeconomic conditions require it. Second, for most banks the risk of assets will be assessed by standard external credit ratings that typically provide a risk weight of 75%-100% for business loans versus a credit risk of 20% for AAA to AA- rated products and 50% for A+ to A- rated products such as sovereign debt and inter-bank claims (OECD, 2012). These reforms, which are aimed at strengthening the resilience of the financial system, could reduce the willingness of banks to advance loans for new business start-ups and may call for a public policy response such as through increasing credit guarantees and microcredit.

Source: EC (2010, 2012, 2013a); OECD (2012a; forthcoming); ECB (2013).

■ BARRIERS TO OBTAINING FINANCE FOR DISADVANTAGED AND UNDER-REPRESENTED GROUPS IN ENTREPRENEURSHIP

The barriers that make access to finance difficult for entrepreneurs from social inclusion target groups fall in four main areas: market barriers, cultural barriers, skills barriers and institutional barriers:

Market barriers. Credit markets suffer from information asymmetries between lenders and borrowers. Often, banks do not have sufficient information to judge the viability of business proposals, especially in the case of new firms. Thus, they provide credit against the provision of collateral that can be seized in the case of loan defaults (i.e. asset-based lending). Since members of disadvantaged and under-represented groups in entrepreneurship tend to own fewer collateral assets (e.g. real estate property, vehicles, etc.), their loan requests are more likely to be rejected. There is also evidence that banks supply more finance to people with large personal wealth (Avery et al., 1998), which further penalises women, young and ethnic-minority entrepreneurs. In principle, banks could apply higher interest rates to compensate for the higher risk-profile of disadvantaged entrepreneurs. However, such a strategy would attract risk-prone borrowers, leading to adverse selection. Borrowers might also be induced into riskier projects to pay back larger loan instalments, which would also result in higher chances of loan defaults (i.e. moral hazard). The result of these market failures is to prevent equal access to finance by entrepreneurs from socially excluded populations.

Cultural barriers. Bank loan officers are trained to deal with a type of business in which the entrepreneur works full-time. Migrant entrepreneurs who manage different businesses at the same time or women entrepreneurs working part-time in their enterprise may be credit-rationed because they fall out of this prototype of client. Cases of social discrimination towards ethnic minority or female entrepreneurs are also possible, although there is not strong evidence of this in EU credit markets (OECD/EC, 2013). Cultural barriers also occur on the demand side of credit markets. Migrant and ethnic minority entrepreneurs may face language and social barriers to building a close and confident relationship with banks. Some groups, for example, may be unwilling to share full information on personal revenues and indebtedness with loan officers, who are perceived as outsiders. Women and youth may not approach

banks because they think that on average female and young entrepreneurs are less likely to obtain a loan than male and senior entrepreneurs, thus turning into “discouraged borrowers” (Kon and Storey, 2003). This is especially true when members of these groups have experienced prolonged periods of labour market inactivity.

Skills barriers. Most loan applications are rejected because the information submitted is incomplete or wrong. This happens more often for entrepreneurs that do not belong to the male white mainstream group. Three common skills barriers involve business planning, business management and financial literacy. Many of the people from disadvantaged and under-represented groups in entrepreneurship who first approach external suppliers of finance have never developed a business plan and have never managed an enterprise before, whereas these are common requirements of lending institutions to give credit. Members of some social target groups (such as low-educated, migrant and senior entrepreneurs) may also lack a good grasp of business finance concepts that are key to understanding the risks and opportunities associated with an entrepreneurial venture (e.g. interest rates, time value of money, etc.). Skills barriers can be addressed through business advice, mentoring schemes and financial education programmes.

Institutional barriers. There are a number of potential problems in the way that finance institutions operate that can affect entrepreneurs from disadvantaged and under-represented groups. For example, some forms of microcredit do not enable beneficiaries to build a credit history, which could eventually help them to obtain loans from senior lending institutions at lower interest rates than those offered in the microfinance sector. Lack of legislation about new sources of finance relevant to disadvantaged entrepreneurs is another example of an institutional barrier. The diffusion of the Internet has made new sources of finance possible (e.g. crowdfunding and peer-to-peer lending), but only recently have policy makers started to legislate on these new channels of business finance. Furthermore, it is generally not enough to enforce a law or introduce a new programme to improve the provision of finance, but it is also important to inform would-be beneficiaries about the change. Information and awareness-raising initiatives are key to overcoming this barrier.

■ TRADITIONAL POLICIES FOR FINANCING BUSINESS START-UP BY EXCLUDED GROUPS

Given the difficulties people from disadvantaged and under-represented groups in entrepreneurship face in obtaining finance for business start-ups, governments and development agencies have traditionally provided support to correct

or compensate for the finance gap. The commonly employed tools have been grants and soft loans. These remain highly relevant today and can work together with or in place of some of the new financing mechanisms that are beginning to emerge.

Grants and income subsidies

Grants and income subsidies are capital transfers by which money ownership is transferred from one party (i.e. the grantor) to another (i.e. the grantee). It is not uncommon for public programmes to transfer grants and subsidies under certain conditions, for example with respect to the final use of the grant. Conditionalities are set to prevent misuse of public resources.

Grants and subsidies have traditionally been used by policy makers to help deprived groups to integrate or re-integrate in the labour market (e.g. job creation schemes and wage subsidies). More recently, they have also been employed to stimulate entrepreneurial activity. The best known example of an income-subsidy policy for nascent entrepreneurs is from Germany, which since the mid-1980s has experimented with schemes that foster business creation among the unemployed.

Box 2 Germany's New Start-Up Subsidy

Target Group: People eligible for unemployment benefits under Germany's federal legislation.

Intervention type: Income-subsidy policy, combined with additional support services such as business planning and coaching. It provides an income subsidy (i.e. the unemployment benefit) and a small grant to secure the livelihood of the unemployed person starting a business and partly overcome the capital constraints associated with the start-up phase.

Objectives: Help unemployed people to enter the labour market via self-employment. It is especially conceived for those groups that are faced with discrimination in the labour market or whose skills and competencies suffer from low demand, as well as for regions and industries undergoing structural change.

Entry requirements: Being eligible for unemployment benefits under German federal legislation and approval of a business plan by an external source (e.g. Chambers of Commerce).

Programme length: 9 months.

Description: The new Start-Up Subsidy (New SUS) was created in 2006 to merge the two previous programmes targeting self-employment by the unemployed in Germany: the Bridging Allowance and the Start-up Subsidy. It provides the unemployed with the benefit she or he would otherwise be eligible for over the first 9 months of the start-up phase. A monthly lump sum of EUR 300 is also transferred for the same time period to cover social contribution requirements; the latter can also be extended for another 6 months.

Results achieved: Robust evaluation results are available for the former Bridging Allowance, which was subsequently merged into the new Start-Up Subsidy with a very similar design. By comparing the performance of participants with non-participants eligible for the programme, the evaluation points to positive income and employment effects especially for the low-educated, the youth and women, reaching the conclusion that the approach is more effective for groups that are disadvantaged in the labour market or in areas where opportunities for wage employment are scarce. The evaluation study also shows that businesses created by the unemployed are not necessarily structurally weak. Even after 5 years from the intervention, as many as 70% of male participants in East Germany and 68% of those in West Germany were still in business, while the lowest survival rate was for women participants in East Germany (56%). Between 30-40% of business founders also created additional jobs beyond their own.

Lessons for other initiatives: Unemployment benefits can be used to subsidise self-employment by the unemployed, provided that the right set of incentives for the unemployed is in place. For example, social security contributions may have to be paid on top of the subsidy, which should be given on a monthly basis rather than as a lump sum. Similar schemes also work better for members of social groups that are discriminated in labour markets or in regions where wage employment opportunities are scarce.

Source: Caliendo, 2013; Caliendo et al., 2012; Caliendo and Künn, 2011.

Soft loans

While not every entrepreneur applies for a bank loan, there are many that do and whose request is rejected. This is where government may intervene by targeting loans on to people who would otherwise find it difficult to obtain them, but who nonetheless have a viable business project (or one that can be made viable with complementary policy

support). At the policy level many EU countries have introduced subsidised loan schemes. An example is so-called "Honour Loans", which have provided many generations of young and female entrepreneurs in Italy and France with a combination of grants and interest-free loans. Honour loans are called so because they are conceded against the borrower's word of honour, without requiring collaterals or other forms of guarantee.

■ NEW AND EMERGING POLICY ACTIONS FOR FINANCING BUSINESS START-UPS IN SOCIAL INCLUSION TARGET GROUPS

New financing mechanisms have recently emerged that can help bridge the gap between lenders and investors, on the one hand, and disadvantaged entrepreneurs, on the other. Some (e.g. loan guarantees, business angels and Islamic finance), have long been in place, but their potential for inclusive entrepreneurship has not yet been fully tapped. Others (e.g. micro-credit and self-financing groups) are relatively new but with a certain tradition in the policy area of financing inclusive entrepreneurship. Still others have only recently arisen thanks to the diffusion of the Internet (e.g. crowdfunding and peer-to-peer lending).

Loan guarantees

Loan guarantees tackle market barriers such as the lack of collateral assets and higher risk profile of new and small enterprises. Loan guarantees have received increasing attention by governments because of their advantages relative to traditional loans and grants, namely the fact that they leverage private sector know-how and resources through the banks participating in the programme to favour the access of disadvantaged entrepreneurs to traditional sources of debt finance. The main driver of banks' participation in this policy is the lower credit risk associated with publicly- or privately-guaranteed loans.

There are three main different models of loan guarantee programmes, often called also credit guarantee schemes (CGSs): public, public-private and mutual (OECD, forthcoming).

- *Public schemes*: they can be either managed directly by the government or implemented in a more decentralised manner via the banking system. The first approach, which is more common of Eastern Europe (Slovenia and Slovakia), tends to see a stronger involvement of government agencies in the decision-making process about the provision of the loan guarantee. The second approach, shared by the United Kingdom and the Netherlands, is implemented via the banking sector with little if any direction on how the guarantee scheme is managed and for which loans the public guarantee is used.
- *Public-private schemes*: they involve both public and private sector players. The government's role can be more or less active, for example in facilitating the creation of the programme. Irrespective of the degree of public sector involvement, the management of the programme (e.g. risk assessment and monitoring of the loan) is left to the lending

institutions. An example of more active involvement is given by the Hungarian government, which sought the involvement of both lending institutions and SME associations when it launched its national guarantee Fund.

- *Private schemes*: they see the strongest commitment by the private sector, generally through bottom-up mutual guarantee associations that group entrepreneurs from the same local business community (e.g. Italy) or from the same industry (e.g. Spain). In this type of CGS, it is the mutual guarantee associations that provide a first assessment of the member who intends to borrow and that are involved in the recovery of losses in case of default. The final lending choice, nonetheless, remains with the bank, which carries out its own full credit risk assessment. The role of the government is limited to setting the regulatory and legal framework and supplying financial assistance, which can take the form of direct funding or counter-guarantees. An example of private CGS is Italy, where the government provides a sizeable last-resort counter-guarantee to banks on top of first-level guarantees offered by local mutual guarantee associations (i.e. called *confidi* in Italy).

A key characteristic of loan guarantee programmes is that the final lending choice is left with banks because they still carry a part of the risk of default, generally anything between 20% and 50% of the loan amount. The risk profile of guarantee-backed loans will not therefore diverge too much from the bank's average client risk profile. As a result, disadvantaged entrepreneurs are at risk of being left out of mainstream CGSs.

If the government is to use CGSs to encourage inclusive entrepreneurship, its role should thus go beyond setting the legal framework and giving counter-guarantees. Guarantee programmes exclusively designed for entrepreneurs from target groups (e.g. young, women, ethnic minorities) are an option, as is the encouragement through public subsidies (e.g. contributions to the registered capital, payments for the running costs of the association, etc.) of mutual guarantee associations among members of target groups working in similar sectors. In both cases, governments should rely on the expertise of private sector lending institutions for credit risk assessment. Lenders, on their part, should continue to carry a small part of the default risk (e.g. 10-20%), so that they have an incentive to apply due diligence in the assessment of loan applications. Maximum default rates should be set beforehand to make CGSs financially sustainable for public finances.

Box 3 Key criteria in setting up a loan guarantee programme for disadvantaged entrepreneurs

Different operational parameters need to be considered by policy makers interested in setting up credit guarantee schemes for disadvantaged entrepreneurs.

Firm eligibility: the main eligibility criterion would be affinity to the target group. An age threshold of 3-5 years can also be included to ensure that the programme caters for new entrepreneurs. A size limit can equally be applied to increase the additionality of the programme, since larger SMEs should be able to obtain credit via traditional credit channels.

Guarantee assignment process: guarantees can be assigned mainly on a *retail* or *portfolio* basis. In the first case, credit risk assessment is done on a personal basis, which implies in-depth knowledge of borrowers but also higher administrative costs. In the second case, guarantees are provided based on some common characteristics of applicants (e.g. sector, locality, etc.).

Coverage ratio: it expresses the degree of protection over defaulted loans provided to lending institutions and can range anywhere between 20% and 100%. Even in the case of disadvantaged entrepreneurs it is, however, recommended that a coverage ratio above 90% is not enforced, since this will reduce the incentive for lending institutions to carry out a proper credit risk assessment. The EU State Aid Framework sets an 80% coverage ratio when public funding is involved in the guarantee coverage, although this threshold has been increased during the crisis up to 90%. A median coverage ratio of 80% was also found in a survey of 76 schemes worldwide (Beck et al., 2010). A coverage ratio between 80% and 90% could be envisaged for our target groups, depending on the hardships they are faced with and evolution of EU State Aid legislation.

Average guarantee period: it is often below 5 years and hardly ever above 10 years. In the case of new businesses, policy makers should acknowledge that the risk associated with start-up loans tend to decrease over time, so long guarantee periods should not be the norm (i.e. less than 5 years). In principle, borrowers who have proven to be reliable or who have meanwhile acquired collaterals should be phased out and turned to traditional credit channels.

Pricing: CGSs typically generate revenues by applying entry fees, annual fees and loan guarantee application fees. Given the restrained personal resources of disadvantaged entrepreneurs, policy makers should envisage a strong subsidisation element to encourage applications and enrolment into programmes by target groups.

Additional services: CGS for entrepreneurs unable to receive credit through commercial channels should finally consider matching the supply of credit with additional services, such as financial education (see below), to increase the likelihood of repayment.

The following summary provides an overview of what a loan guarantee programme for disadvantaged entrepreneurs could resemble to:

- *Entrepreneur eligibility:* Based on affinity to target groups and credit worthiness.
- *Assignment process:* Retail or portfolio-based.
- *Coverage ratio:* High, 80%-90% of the loan amount, but in line with EU legislation.
- *Average guarantee period:* Less than 5 years.
- *Pricing:* Strong subsidy component should be envisaged.
- *Additional services:* Financial education and business development advice to boost chances of repayment.

Loan guarantee programmes have several advantages from a government point of view. They leverage on the expertise of the banking sector for credit risk assessment, which lowers the risks of government failures. Their cost is in large part proportional to the loan default rate, so that if the programme is run properly it will be a low-cost policy option (although large funds will have to be set aside to cover for possible defaults and convince banks to participate). They favour the integration of marginal groups into the mainstream credit system and show to commercial banks that disadvantaged entrepreneurs can be profitable clients. On the downside, CGSs have traditionally been conceived for the average small firm, so that their use by disadvantaged entrepreneurs requires some tweaks. Moreover, if the default risk is not fairly shared among the parties, the scheme lends itself to opportunistic behaviours by lenders and borrowers. Finally, public schemes where the government plays an active role in the monitoring and assessment of loan

guarantees present higher operating costs and are subject to picking-winner problems.

The pros and cons of loan guarantee programmes are confirmed by existing empirical evidence. Loan guarantees have been found to improve credit conditions for SMEs (e.g. the size, maturity and interest rates of the loans), but the evidence for an impact on increasing the number of loan beneficiaries and business start-ups is less conclusive. In France, the guarantee programme operated by OSEO, the government SME financing agency, throughout the 1990s resulted in increased loan volumes and sales growth for the beneficiaries, but did not affect the overall start-up rate in the economy (Lelarge et al., 2010). Since then, OSEO has recalibrated the scheme towards the needs of start-ups, which came to represent 75% of the beneficiary firms and 35% of total funding in 2011 (OECD, 2013). A series of studies on the Italian loan guarantee system also

suggest that the impact of loan guarantee policy is stronger on credit conditions than on credit expansion (Columba et al, 2010; D'Ignazio and Menon, 2013). In Italy, the schemes have lowered interest rates, lengthened loan maturity and increased loan volumes, but they have not favoured the creation of new firms. In addition, the positive effect of affiliation to a mutual guarantee scheme has been larger for those firms with shorter lending relationships with banks. In the United Kingdom, on the other hand, participation in the national Small Firm Loan Guarantee Scheme has made beneficiary firms more likely to export and hire new workers than similar non-borrowing firms (Cowling, 2010). Moreover, ethnic minority businesses and businesses located in disadvantaged areas have been over-represented in this scheme, which has therefore strengthened inclusive entrepreneurship in the country.

The European Commission supports loan guarantee programmes through the Joint European Resources for Micro to Medium Enterprises (JEREMIE) initiative. Policy makers can use EU structural funds to invest in revolving financing instruments such as venture capital, loan or guarantee funds that promote, among other things, the creation of new businesses. One of the main benefits of the JEREMIE initiative is its portfolio-based approach. National and regional Funds can allocate JEREMIE resources to instruments with different risk profiles, thus spreading risk across the portfolio of instruments, although JEREMIE also requires national and local Funds to be able to generate revenues out of the whole range of products and become self-sustainable. This leaves policy makers with some room for introducing relatively riskier products such as CGSs for disadvantaged entrepreneurs, which can eventually be cross-subsidised by safer products generating stronger revenues.

Microcredit

Microcredit aims to tackle market barriers and cultural barriers at the same time, for commercial banks lend against the provision of collateral and with a type of business in mind that does not necessarily fit the one run by migrants, women or young entrepreneurs. If combined with financial education and business advice, microcredit can address skills barriers in access to finance as well.

In the European Union microcredit refers to loans of less than EUR 25 000 for micro-enterprises employing less than 10 employees, self-employed or unemployed and inactive people who want

to move into self-employment but do not have access to traditional banking services (EIF, 2009). Microcredit first emerged in developing countries and reached Europe only more recently. The first microfinance institutions (MFIs) date back to the 1980s in Eastern Europe and to the 2000s in Western Europe.⁽⁵⁾ This different timing has led to a divide in the EU microcredit model. In eastern countries, for-profit organisations and credit unions dominate the sector, whereas in western countries the market mainly consists of non-governmental organisations (NGOs) and non-banking financial institutions (NBFIs).

With respect to the services offer, most MFIs combine credit with business support and other financial services (e.g. consumer credit, insurances, etc.); only between 25%-30% of European MFIs implement microcredit without additional support services (Underwood, 2006; EMN, 2010). The business model of MFIs, therefore, relies on a combined product offer, higher-than-average interest rates, and loan application fees. Nonetheless, the sector still largely depends on public support to cover both operational costs and the loan capital, as shown by the 63% average repayment ratio of the EMN-surveyed MFIs (EMN, 2010).⁽⁶⁾

Disadvantaged and underrepresented entrepreneurs are important targets of MFIs, but less than it could be expected. Of the 170 microcredit institutions covered by the most recent EMN survey (EMN, 2010), as many as 44% reported targeting women, 41% ethnic minorities and migrants, 32% the unemployed, 29% the youth, and 21% the disabled. However, when looking at the proportions of microloan clients, only 27% were women, 13% were immigrants or members of ethnic minorities, and 10% were young people (aged 15-24), despite the stated desire of many MFIs to cater for these groups. The proportion of women is far lower than the corresponding share in the developing world, while immigrants and ethnic minorities are underrepresented compared to their incidence in the EU entrepreneurial population.

Digging more deeply into the reasons for this inconsistency suggests that one issue could be discrimination against disadvantaged and under-represented groups, even among microcredit providers. In the case of France, there is some evidence that microcredit conditions (e.g. size of the loan and interest rate) for women are worse than for men, and cannot be explained by either the characteristics of the entrepreneur (e.g. age, work experience, education, etc.) or those of the firm (e.g. business size, business age, industry, etc.) (Brana, 2013).

⁽⁵⁾ There are, however, some exceptions. For example, ADIE in France was set up in 1989.

⁽⁶⁾ The EMN survey provides a snapshot about the MFIs that have responded to the questionnaire; thus this picture does not necessarily reflect that of the EU's microcredit market as a whole.

Box 4 Setting up a microcredit programme

Policy makers are faced with important choices when setting up a microcredit scheme. One concerns the Fund operator, which can either be selected through a public call for tender or be chosen without any tender among existing public institutions with experience in Fund management. The first option has the advantage of drawing on the most cost-effective solution to the government. The second option will ensure better coherence between the Fund's operations and the government's strategic objectives (COPIE, undated).

A second choice regards the financial intermediary organisation that will deliver the scheme, which can be an *ad-hoc* government body or be chosen among existing players in the credit market (e.g. commercial banks, non-bank financial institutions, credit unions, etc.), generally through a call for tender. The first option will have the main benefit of building an organisation tailored to its mission, but which will have high overhead costs, especially if the microcredit programme is only temporary. The second will have the main advantage of leveraging on the expertise of players already active in the credit market, but who may not devote the same level of attention to microcredit than to their other activities.

Microcredit schemes require an attentive distribution of costs among participants, namely government, providers and clients. There are several fixed costs involved in a microcredit scheme, including the loan capital, operating and refinancing costs, loan assessment and monitoring costs, etc. Additional services such as interest rebates, financial advice and education, and business development training also imply costs for microcredit providers.

Microcredit initiatives are, therefore, unlikely to become fully self-sustainable, and policy makers should expect a strong element of subsidisation. This will be especially true for programmes for disadvantaged entrepreneurs who may need complementary services such as interest rebates and business training to be pulled in the scheme. The provision of additional services, together with better communication targeting both disadvantaged entrepreneurs and MFIs, should be part of a comprehensive strategy aimed at making microcredit more inclusive than has been so far.

The main advantage of microcredit is that, unlike other products (e.g. guarantees, crowdfunding, etc.), it is a mechanism specifically devised for entrepreneurs who experience difficulties in the credit market. Microcredit also helps build the credit history of its clients, thus favouring their access to traditional sources of finance. On the other hand, microcredit is unlikely to become financially self-sustainable. The harder-to-reach is the target group, the stronger will be the degree of subsidisation. A marginal risk is also that microcredit, rather

than strengthening the credit history of clients, further marginalises them into a segmented credit market due to social stigma attributed to microcredit clients by senior lending institutions.

There are many microcredit initiatives in the EU that deserve attention. The case of Fair Finance in London and *Crédal* in Belgium are reported in Boxes 5 and 6 to show how two different approaches work.

Box 5 The UK Fair Finance Microcredit Programme

Target Group: Unbankable clients who have fallen prey to money lenders applying usury loan terms.

Intervention type: Microcredit and financial education together. UK Fair Finance benefits from guarantees by the European Progress Microfinance Facility.

Objectives: To help unbankable clients out of usury loans through fair credit conditions and financial education. Clients also include disadvantaged entrepreneurs through loans up to GBP 10 000.

Entry requirements: Clients must present feasible financing requests, e.g. repayment of the micro loan must be possible. Financial education is accessible for selected target groups.

Description: Fair Finance was launched in 2005 as a spin-off of two successful microcredit and debt advice programmes. The first helped over 600 women on peer group circles and made over 300 loans to excluded women in East London. The second worked with Local Housing Associations to provide debt advice to indebted house tenants. Today Fair Finance is a not-for-profit social enterprise that works with unbankable clients to provide them with fair credit conditions and advice on debt management. The ultimate goal is to prevent clients from resorting to usury loans in the black credit market that would further worsen their financial debt situation. The programme also develops relationship with traditional banks so that unbankable clients can open bank accounts in the Fair Finance's offices. To sum up, the range of products offered are: i) personal loans of up to GBP 2 000 at affordable rates to help clients out of usury loans; ii) loans of up to GBP 10 000 to entrepreneurs unable to access mainstream finance to develop their business idea; iii) debt advice and financial capability workshop to local residents to improve their financial management skills; iv) bank account access for people without one.

Results achieved: in 2011 Fair Finance secured investments from a range of social investors to build its business across London, and commercial finance from 3 banks to expand its loan capital.

Lessons for other initiatives: Strong leadership and strict administrative procedures are needed to launch effective microcredit programmes; targeted approaches in microcredit result in bringing excluded groups into mainstream economy; access to microcredit can reduce financial burdens, but not necessarily results in business development; transparency in financing (for instance through open information on websites) is an effective tool for promotion and marketing; considerable time needed to attract funding from private sources for the expansion of the model; support services such as financial education are effective in improving the general understanding of the borrowing process and can reduce over-indebtedness.

Box 6 Belgium's *Crédal* Microfinance Co-operative

Target Group: Financially excluded people due to low income, lack of guarantees or bad credit history.

Intervention type: Start-up microloans and social credit, with the participation of the European Social Fund, the Walloon region, the Brussels region, and the banking sector. *Crédal* also benefits from guarantees by the European Progress Microfinance Facility.

Objectives: To strengthen the financial inclusion of non-bankable people that would not be able to receive credit from senior lending institutions.

Entry requirements: For start-up microloans, being interested in becoming self-employed but having been rejected by a senior lending institution.

Programme length: Repayment period for microloans is up to 48 months.

Description: *Crédal* was founded in 1984 with the vision of reinforcing social cohesion. Its first activity was to finance non-profit organisations and cooperatives through various traditional credit mechanisms at low interest rates. In 2000, *Crédal* started a microcredit programme targeting credit-excluded people who wanted to start a business but could not obtain suitable finance from traditional banks. The size of loans ranges from EUR 500 to EUR 12 500, repayment is due within 48 months, and the charged interest rate is 5%. Microcredit is combined with other microfinance instruments such as "social credit", which addresses the transport, training or health-related needs of low-income.

Results achieved: In 2012, *Crédal* granted 642 microloans for business start-ups and 2 032 social loans.

Lessons for other initiatives: Target group approach is effective; multi-stakeholder support in terms of financing is needed in the start-up and expansion phases of the microcredit activity; subsidies for operational costs and supporting services are justified to ensure that a fair (but still market-level) interest rate is charged.

Microcredit plays a central role in the European Union's strategy for financial inclusion and inclusive growth. In 2010, the Commission's Directorate General for Employment, Social Affairs and Inclusion set up the European "Progress Microfinance" Facility, which absorbed previous smaller initiatives in the field and represents the first EU-wide initiative designed specifically for the microfinance sector (EC, 2013b).⁽⁷⁾ Jointly funded by the European Commission and the European Investment Bank, "Progress Microfinance" follows a two-pronged approach. On the one hand, it provides guarantees and counter-guarantees to lending institutions (banks, microcredit providers, etc.) to support their portfolios of microloans. On the other, it offers the same eligible institutions four types of funded instruments: senior loans, subordinated loans, risk-sharing loans and equity participations. The guarantee mechanism has been allocated EUR 25 million by the European Commission, while the four funded instruments are jointly supported by the European Commission (EUR 80 million) and the European Investment Bank (EUR 100 million) (EIF, 2012).

In June 2013, it was decided to further integrate "Progress Microfinance" into a wider EU initiative for employment and social cohesion; the EU programme for "Employment and Social Innovation" (EaSI). EaSI integrates and extends the coverage of three existing programmes: i) Progress (Programme for Employment and Social Solidarity); ii) EURES (European Employment Services); and iii) "Progress Microfinance". The latter will receive 21% of the overall EaSI budget. There will also be extended coverage for social enterprises and funding for capacity-building in microfinance institutions.

Alternative debt finance

Overdrafts, factoring, leasing and trade credit are important sources of debt finance alternative to bank loans. There is evidence that small businesses use these sources of finance extensively, with more than one-quarter using trade credit, more than one-third using leasing, hire purchase and factoring, and more than one-third using credit lines and overdrafts (European Central Bank, 2013; European Commission, 2011). With the possible exception of trade credit, alternative sources of debt finance are more expensive than loans and are gleaned mainly when bank credit is unavailable or difficult to obtain.

From a policy perspective, alternative credit financing can be influenced by national (and sometimes local) regulatory reforms impacting on leasing contracts, factoring legislation, fees and interest rates on overdrafts, etc. Factoring can also be affected by public procurement to the extent that the public administration represents an important player in this industry. For example, one-third of transferred receivables in Italy are from the public sector.⁽⁸⁾

Since entrepreneurs from disadvantaged groups find it difficult to obtain commercial bank loans, alternative debt finance is relevant to them. Policy can help by pointing disadvantaged and under-represented entrepreneurs to these sources of finance, e.g. through information, advice and mentoring. It can also lobby with banks, especially community-based ones (e.g. savings banks and cooperative banks), to help disadvantaged

⁽⁷⁾ Further information about Progress Microfinance is available at <http://ec.europa.eu/epmf>

⁽⁸⁾ "The Italian job: post-crisis factoring in Italy", http://www.factorscan.com/folder_detail.aspx?id=89F6888F-7BD0-45FF-9055-12A96B4F9EE9, retrieved on 02/04/2013.

entrepreneurs obtain a bank account and credit line. Credit lines can be subsidised through interest rebates, which will lower the debt burden on those who may already have limited assets and a negative credit history. Trade credit is also relevant because it is common in the retailing industry, where migrant and ethnic entrepreneurs are disproportionally represented. There is scope for raising awareness among this target group about the role of trade credit for enterprise financing.

Crowdfunding

Crowdfunding addresses market, cultural and institutional barriers in access to finance by disadvantaged entrepreneurs and responds to the idea that enterprise financing comes from a multitude of people who invest (small) sums, rather than from a single large institution, usually via the Internet. The main advantage for both entrepreneurs and investors lie in the low intermediation costs of crowdfunding, which makes it a cheaper source of finance compared to loan and loan guarantees. Intermediation costs are dropped for three reasons. First, the assessment of business proposals is less thorough than for bank loans because crowdfunding companies do not carry the risk of failure related to the proposals they post on their web portal. Although a health-check of business pitches is common to many platforms, there is no incentive for them to undertake a systematic risk analysis. Second, the project follow-up (i.e. monitoring costs) is also minimal and generally left to the direct contact between the entrepreneur and the investors, with the crowdfunding website acting as a virtual meeting point. Third, relying strongly on the Internet, crowdfunding portals have low fixed costs (e.g. staff and office space).

Crowdfunding comes under four main categories, although variants and hybrid forms co-exist (De Buysere et al., 2012):

- Donations: in crowdfunding donations are collected and earmarked for specific projects, which have often a social nature.
- Rewards: the investee provides the investor with a reward that can be of non-monetary nature (e.g. the product that the investor is financing) and which is of lower value than the sum offered.
- Lending: thanks to lower intermediation costs, borrowers pay a lower interest rate than for bank loans, while lenders receive a higher interest rate than for savings deposits.
- Equity: this is less common than the other three options and involves larger sums. Equity crowdfunding is rather similar to the activity of business angels, although in crowdfunding the local dimension of the investment and its business advice component are less strong (Agrawal et al., 2011).

In the first three types of crowdfunding, suppliers of finance are often not only motivated by profit-seeking but also by emotional and social objectives. This, together with the

small sums involved, makes crowdfunding relevant to inclusive entrepreneurship.

Crowdfunding is a very new market and estimates of its size need to be taken with caution. De Buysere et al. (2012) report that in 2011 there were around 200 platforms in Europe which had raised EUR 300 million of funding. This corresponded to one-half of the total number of platforms worldwide and one-fourth of the global crowdfunding market (EUR 1.2 billion). The average platform in Europe therefore raises less funding than the global average.

The average size of the business pitch changes greatly in Europe depending on the type of crowdfunding. It is approximately EUR 500 for donations, EUR 3 000 for rewards, EUR 4 500 for lending, and EUR 50 000 for equity-based crowdfunding. All these forms of crowdfunding are on the rise in Europe, although donations take the lion's share with respect to the absolute number of crowdfunding campaigns.

Policy-wise, there is an increasing request for better regulation of crowdfunding. The downside of low intermediation costs is, in fact, low control by crowdfunding platforms on the viability and progress of the business proposals they host. Similarly, information on business projects is limited to what entrepreneurs are willing to disclose, whereas more structured and homogenous information requirements would help investors to make a better choice.

Since crowdfunding is a very new market and disadvantaged entrepreneurs are not always up-to-date with the latest evolutions in business financing, there is scope for strengthening information about this financing mechanism. Financial education of both entrepreneurs and investors will help them to understand mutual expectations and obligations related to crowdfunding transactions. Training and advice for disadvantaged entrepreneurs will have to focus on debt management issues or, should crowdfunding be equity-based, on the implications of external equity for business ownership and business management. Investors, too, would benefit from help in the assessment of business pitches. Since much of crowdfunding is also driven by social considerations, advice will need to go beyond traditional concepts such as returns on investment (ROI).

The relevance of crowdfunding is also related to being one of the few equity options available to disadvantaged entrepreneurs. Small sums of equity will be especially useful to innovative entrepreneurial projects run by young or migrant entrepreneurs or that address societal challenges (e.g. population ageing, global warming, etc.). The support of equity-based crowdfunding, however, also calls for the parallel development of senior investors (e.g. business angels) and secondary markets to guarantee exit options for those who have invested through equity-based crowdfunding.

Seedmatch provides an example of the potential of equity-based crowdfunding for youth entrepreneurship.

Box 7 Germany's Seedmatch Crowdfunding Platform

Target Group: Start-ups looking for small sums of equity finance.

Objectives: To strengthen the capitalisation of new start-ups by making access to external equity finance possible.

Intervention type: Equity-based investment.

Programme length: Between 5 and 7 years.

Description: *Seedmatch* is one of the few equity-based platforms in Europe, enabling funders to invest in new start-ups and receive shares in return. *Seedmatch* carries out an in-depth assessment of the business proposals, which abide by transparency requirements, and only posts on the platform those that consider worth of investment. This means that they target companies with innovation potential and scalable business models. They receive around 1 000 applications per year, long-list 200, short-list no more than 50 for interview, and finally post online for investment around 25. Minimum investment is EUR 200, while the average investment is EUR 600. From a demographic point of view, young entrepreneurs are quite strongly represented among the business founders admitted to the stage of investment, possibly because of the "new" and Internet-based nature of this model of business financing.

Results: Until now the platform counts approximately 12 500 registered users and has funded 34 business start-ups for an investment capital of EUR 3.85 million.

Lessons for other initiatives: Entrepreneurs must be able to clearly present their business plans and ideas to potential investors; crowdfunding through subordinated loans and equity investments can be an effective tool for innovative start-ups; investment exit strategies need to be in place at the outset of the funding campaign; platforms have difficulty in becoming self-sustainable if the number and volume of transactions remain small.

Source : Molenaar, 2013

Peer-to-peer lending

Peer-to-peer (P2P) lending is similar to lending-based crowdfunding. Interest rates in these transactions are higher than for bank loans, this being the main rationale for the involvement of lenders. However, it is not uncommon for P2P lending to be based on subordinated loans, i.e. loans that in case of liquidation can only be claimed after borrowers have paid senior lenders. On the borrower's side, P2P lending requires fewer personal securities than bank lending, although higher-than-average interest rates will result in higher levels of indebtedness. Interest rates in P2P lending are set by managing platforms and funds, based on the financial information and personal securities of the borrower. In some innovative cases, peer-to-peer platforms can carry part of the default risk or provide partial insurance against loan defaults.

The volume of peer-to-peer lending is appraised at EUR 20 million per month in Europe (De Buysere et al., 2012), although estimates are only approximate. Success stories in P2P lending platforms include Funding Circle in the UK and Smava in Germany.

Peer-to-peer lending is meaningful to inclusive entrepreneurship for two main reasons. First, it will favour access to finance to non-bankable entrepreneurs, although the risk of over-indebtedness should not be underestimated. Secondly, it can encourage the transfer of resources among members of the same community (i.e. peers). This makes it relevant, for example, to migrant and ethnic-minority entrepreneurship thanks to the possible support of diaspora members.

The development of peer-to-peer lending will require government action similar to the one suited for crowdfunding, covering areas such as regulation, financial education and information. In the case of peer-to-peer lending, improved regulation will involve enhanced information on the borrower's profile and on the distribution of the default risk between online platforms and investors.⁽⁹⁾ Reformers should however take into account that increased transparency will entail increased costs and thus strike the right balance between the protection of investors and the development of new promising sources of business finance. Policy makers can further support P2P lending for inclusive entrepreneurship through fiscal incentives for investors and platforms with a focus on certain target groups or, at local level, by facilitating the matchmaking between entrepreneurs and investors.

Business angels

Business angels are net worth individuals who invest sums of equity finance in an unquoted business in which they have no family connection with the goal of making a profit in the medium to long-term. In addition to providing finance, business angels are also a source of business advice and professional networks. The size of business angels' investment tends to vary between EUR 25 000 and 500 000, but it can reach larger scale when they invest through networks, clubs or syndicates.

⁽⁹⁾ The Bank of France has, for instance, recently declared that crowdfunding platforms would have to abide by the same obligations ruling banks and other financial institutions, which also implies the presence of capital requirements. Le Monde, TPE: la voie étroite du crowdfunding, 25/03/2013. http://www.lemonde.fr/economie/article/2013/03/25/tpe-la-voie-etroite-du-crowdfunding_1853646_3234.html

The business angel market in Europe is estimated at EUR 5 billion, only 10% of which is visible through the 460 business angel networks identified by the European Trade Association for Business Angels (EBAN). The five biggest markets in the EU are the UK, Spain, France, Finland and Germany, and the average investment per company is EUR 175 000.⁽¹⁰⁾

Although business angels are often associated with high-growth entrepreneurship, they can play a role in inclusive entrepreneurship, too. It should, however, be recalled that profit-making is one of the main drivers of business angel investment, which is therefore naturally geared towards growth-oriented sectors. This is shown by the sector bias of business angel investment in Europe, 70% of which goes to information and communications technologies and biotech together, while less than 10% is directed to consumer goods and services and retail.

This helps explain why women-owned businesses, which are less growth-oriented than men-owned businesses even within high-tech sectors, only capture a very small fraction of business angel investment and equity finance.⁽¹¹⁾ Women are also less likely to become business angels, representing less than 5% of the business angel population, which may help explain the low proportion of business angel investment directed to women-owned businesses, although female business angels are not particularly influenced by gender considerations in their investment decisions (Harrison and Mason, 2007).

When female entrepreneurs look for external equity investment, they rely extensively on their personal networks of family and friends to reach out to business angels and win their trust (Amatucci and Sohl, 2004). This pattern is common to the entire business angel sector, which is small-sized and driven by personal and affinity relationships. But it means that female and young entrepreneurs, who have typically less extensive personal networks, will be at a disadvantage compared to their male and senior counterparts. For the same reasons, immigrant entrepreneurs can benefit from business angel investment from investors in their home countries provided that they keep ties with the country of origin. Silicon Valley in the United States is a case in point of a place where social networks of migrants have evolved into professional and business associations, which have helped build a two-way bridge where equity investments flow between host and home countries (Saxenian, 2006).

Policy makers in the EU can support business angel investment for socially excluded entrepreneurs in various ways. First, the

creation of affinity business angel networks can be encouraged, for example, by subsidising their operational costs. There are a few examples of female and diaspora angel groups already existing in Europe, although they are more likely to operate in places where there is a high density of entrepreneurship that provides a constant flow of investment opportunities (e.g. London and Cambridge in the UK) (OECD, 2011). Second, the investment readiness of targeted entrepreneurs can be strengthened through ad-hoc programmes that aim to enhance the investment prospects of their business pitches. A study of deals declined by UK business angels highlighted three dominant reasons for rejection: weakness in the entrepreneur or management team, marketing factors and flawed financial projections (Mason and Kwok, 2010). Investment readiness programme could start with addressing these issues. Third, tax breaks are commonly used to stimulate the business angel market. Special tax breaks can be envisioned for those business angel networks that invest in enterprises launched by members of disadvantaged and under-represented groups in entrepreneurship. Fourth, public co-investment in business angel networks targeting inclusive entrepreneurship is another policy option, although policy makers should leave investment decisions to private investors better placed to assess the growth prospects of the financed business. Finally, initiatives that facilitate matchmaking between investors and entrepreneurs from disadvantaged and under-represented groups are a low-cost policy option that can help trigger initial interest in equity finance for inclusive entrepreneurship.

Islamic finance

Muslims in Europe are estimated at 44 million (6% of the overall population) and projected to increase to 58 million within the next 20 years.⁽¹²⁾ Within the European Union, estimates point to about 19 million of Muslims, 3.8% of the EU population (Pew Forum, 2011). The presence of Muslims is stronger in Western and Northern Europe, particularly in the Netherlands, Belgium, France and the United Kingdom due to the inflow of Muslim migrants and second-generation Muslim Europeans. Muslims are especially concentrated in urban areas. They are 24% of the population in Amsterdam, 17% in Brussels, 10-15% in the Paris region and 8.5% in Greater London.⁽¹³⁾ Islamic finance, which refers to financing tools complying with Sharia-law that forbids interest rates, could help the promotion of migrant and ethnic minority entrepreneurship in certain countries and regions.

⁽¹⁰⁾ Data on the European business angel market are drawn from the EBAN "European Angel Investment Overview: 2012". <http://www.eban.org/wp-content/uploads/2013/07/EBAN-Angel-Investment-Overview-2012.pdf>

⁽¹¹⁾ In the United States, for example, women represent only 7% of venture capital clients.

⁽¹²⁾ This estimate excludes Turkey but includes Russia.

⁽¹³⁾ The Economist, When Town Halls Turn to La Mecca, 4 December 2008, retrieved 10/07/2013. http://www.economist.com/node/12724966?story_id=12724966

Box 8 Major Islamic finance products

Some of the major Islamic finance investment vehicles are the following:

- Profit sharing (i.e. *mudharabah*): The investor supplies the entrepreneur with funds and receives a return, based on an agreed profit-sharing ratio. This principle can apply both to bank deposits and business financing. Eventual losses are suffered by the provider of capital.
- Cost plus (i.e. *murabahah*): This transaction involves the sale of goods at a price which includes a profit margin agreed by both parties. However, in *Murabahah*, sellers must let buyers know the actual cost of the assets at the time of the initial agreement.
- Joint venture (i.e. *musharakah*): It refers to a partnership in which profits will be shared based on an agreed ratio which may not be in the same proportion of the invested amounts. On the other hand, incurred losses will be shared according to the original ratio invested by each partner.
- Agency (i.e. *wakalah*): This is a contract whereby a person (principal) asks another to act on his/her behalf for a specific task. The person who takes on the task is an agent who will be paid a fee for the service.
- Interest-free financing (i.e. *quard*): financing is given for a fixed period on a goodwill basis and the borrower is only required to repay the amount borrowed. However, borrowers may pay an extra amount as a way to thank the lender if they wish so.

Source: Molenaar, 2013

There has been a recent surge in the number of Islamic financial institutions worldwide, mainly banks and funds, although they have so far privileged large investment operations over lending to entrepreneurs. Many countries are behind the game in terms of the number of Islamic finance institutions and the volume of their lending.

Policy makers in Europe can contribute to reversing this trend by supporting the introduction of Sharia-compliant financial products within major commercial banks. This will most likely require the training of loan officers charged with the offer of Islamic finance products. Awareness-raising campaigns will also be important on both the demand and supply sides. Muslim entrepreneurs may be unaware of new Sharia-compliant products in the credit market, while financial institutions that offer

these products need to be ushered into lending to entrepreneurs. Community-based organisations can help spread the voice about Islamic finance opportunities among Muslim entrepreneurs.

Islamic finance can positively impact on the integration of hard-to-reach entrepreneurs who would not look for credit unless it abides by their religious beliefs. However, policy makers should be aware that recent experiments to introduce Islamic finance products have not always been successful in Europe, partly because of the low income and low activity rates of the target population (Stressman Foundation, 2012).

The UK is the country in the European Union where Islamic finance has advanced the most, with the Islamic Bank of Britain standing out as the only fully Sharia-compliant bank in the country.

Box 9 Islamic Bank of Britain

Target Group: Muslims interested in financial products, not only related to business financing, compliant with Sharia law.

Objectives: To offer alternative sources of financing to segments of the UK population who, for religious beliefs, are not willing to pay interest rates on borrowed money.

Intervention type: retail banking, mainly savings products and overdrafts facilities.

Programme length: Authorised to operate under UK banking law since 2004, including credit facilities.

Description: The Islamic Bank of Britain (IBB) offers the largest range of Sharia-compliant financial products in the UK, including mortgage alternatives, current accounts, savings accounts, and assets management solutions. The major shareholder is Qatar International Islamic Bank (over 80%), with the remaining 20% shared between large private investors and the general public.

Results: IBB has opened up new banking opportunities for the UK Muslim population, although the share of portfolio covered by small businesses and individual clients remains marginal. Most business financing is still concentrated in large operations.

Lessons for other initiatives: Faith-based schemes operate in closed target markets and are therefore subject to less competition and to reliance on standard products; if Islamic finance is to be used for entrepreneurship financing, clear promotion campaigns are required; Islamic banks need to devise appropriate services packages to cater for small business owners; Islamic finance products are typically more expensive than traditional bank products.

Source: Moolenaar, 2003

Self-financing groups

Self-financing groups are community-based systems in which members lend to each other. They have originally arisen in developing countries, where the most common form has been Rotating Savings and Credit Associations (ROSCA). More recently, they have also mushroomed in Europe, namely in Spain, Italy, Portugal, Hungary, Belgium and the Netherlands (Molenaar, 2013).

Loans in self-financing groups are proportional to the deposits of members. An interest rate can be applied, in which case profits are re-invested in the group. Loans are in the range of EUR 5 000, with repayment periods often within 6 months

and never longer than a year. The evidence from developing countries points to high repayment rates in group lending (Ledgerwood, 1998), although some argue that by self-selecting their members self-financing groups exclude those at the very margins of the society (Green, 2005).

Self-financing groups have the potential to enhance the resilience of vulnerable entrepreneurs (e.g. migrants and disabled people), although linkages with more structured forms of public support are important to avoid the marginalisation of members. Policy-wise, it will therefore be important to encourage ties between self-financing groups and, for example, microcredit institutions to support the financial inclusion of group members.

Box 10 Spain's Association of Self-financed Communities (ACAF)

Target Group: Low-income people who are financially and socially excluded, often with a migrant background.

Objectives: To offer alternative sources of debt finance to non-bankable people.

Intervention type: Small sums of debt finance for income-generating activities.

Programme length: Continuous cycles of one year.

Description: Since 2004 the Spanish foundation Asociación de Comunidades Autofinanciadas (ACAF) has gained experience in setting up and managing self-funded groups. Partners in ACAF involve the large-scale NGO Ashoka, the Levi Strauss Foundation and the Catalan regional government. Each "self-funded" community (CAF) can be composed of 10 to 30 people who, through the investment of small sums, become the owners and customers of the organisation. CAFs provide services to their members, such as credit and insurance, while generating revenues through interests applied to loans. The model differs from traditional microcredit because it does not rely on external funds. More recently, through the creation of the Winkomun platform (www.winkomun.org), the organisation has aimed to disseminate more effectively the experience of CAFs, facilitate access to the methodology of how to build a CAF, and promote interaction between members of CAF communities.

Results: Since 2004, ACAF has assisted the foundation of about 80 self-financed groups, with more than 3 500 indirect beneficiaries.

Lessons for other initiatives: Self-financing groups are an effective tool to promote social inclusion, including through start-up funding; complementary social orientation and mobilisation programmes are needed to trigger the creation of self-help groups; a clear structure helps accelerate the establishment and operations of self-financing groups.

Source: Molenaar, 2013

THE ROLE OF FINANCIAL EDUCATION

The discussion has hitherto focused on how policy can strengthen the supply of finance, based on evidence that some groups of entrepreneurs are disadvantaged, if not discriminated, in credit markets (Muravyev et al. 2009; Alesina et al., 2013; Fairlie, 2010). These initiatives should be coupled with financial education interventions aimed at overcoming skills barriers in access to finance. The objective should be to make disadvantaged entrepreneurs ready to receive a loan or investment at market conditions.

A recent OECD survey on knowledge, attitudes and behaviours around financial issues points to significant knowledge gaps within the adult population (Atkinson and Messy, 2012). The proportion of the population with high scores in financial

knowledge ranges between 40% in Norway and 69% in Hungary among the EU countries covered by the survey.⁽¹⁴⁾

Strong differences in financial knowledge are observed across different socio-demographic groups. Women have on average lower scores than men, with a gender gap above 20 percentage points in Norway, Poland and the UK. While 67% of men in Germany and the United Kingdom reach a high score in financial knowledge, the share for women is respectively 50% and 40%.

⁽¹⁴⁾ The category of financial knowledge included non-specialist questions on "division", "time value of money", "interest paid on loan", "calculation of interest plus principle", "compound interest", "risk and return", "definition of inflation", "diversification".

Age, income and level of education also matter. Respondents with high scores in financial knowledge are most likely to be in the age group between 30 and 60 years old, while the youngest and oldest respondents do comparatively worse. People with high levels of education also obtain better scores in financial knowledge, with the largest education-based gap in financial knowledge in Germany and Poland. Yet, people with little or no formal education also achieve high scores, which suggests that financial education can be delivered across a wide range of social groups. Finally, those with high income have better financial knowledge than those with low income, although income is also positively correlated with age and level of education (Atkinson and Messy, 2012).

Financial knowledge influences financial attitudes and behaviours. Those who rank high in financial knowledge will also show stronger propensity to saving and to appropriate financial behaviours (e.g. sound budget management, timely payment of bills, etc.). An exception is represented by women, who do better than men with respect to financial attitudes and behaviours in spite of lower scores in financial knowledge.

Improving financial literacy skills through financial education is, therefore, an important policy area. This is especially true for entrepreneurs from disadvantaged groups, since the way they manage their business and connect with credit markets will affect their livelihood and that of their families. In this respect, it is generally recommended that financial education programmes be strongly tailored, because initial financial

knowledge will vary a great deal among participants (OECD, 2012b). Programmes should also be of hands-on nature, drawing on experiential and interactive methodologies. The ultimate goal should be to influence attitudes and behaviours, rather than focus on financial concepts and principles. Timing is also important and should be close to when education is most likely to have an impact. Including financial education principles in vocational education colleges, self-employment training courses or still in active labour market programmes for the unemployed can make inclusive entrepreneurship stronger. Policy makers should also work on the qualification and accreditation of financial education providers to guarantee quality in the offer of training, while banks and other financial institutions should be encouraged to communicate with clients in a language that is as simple as possible (OECD, 2005).

In addition to being offered through bespoke programmes, financial education can be integrated into other schemes. This is, in fact, the best way to deliver financial education because training will have a practical end and will be delivered at a time when it is most likely to have an impact. Some micro-finance programmes (e.g. Bulgaria's JOBS Financial Leasing – see Box 11), income-subsidy programmes (e.g. Germany's Start-up Subsidy) and subsidised credit programmes (e.g. Italy's Honour Loans) provide good practice examples, but still too often financing schemes do not foresee a component that strengthens the financial knowledge of participants. Expected benefits from this policy change would include lower rejections in loan applications and lower rates of loan default.

Box 11 “Job Opportunities through Business Support” (JOBS) Financial Leasing Project, Bulgaria

Target Group: Unbankable low-income people who already run a micro or small business or intend to start a new one. The project mainly operates in rural areas (40% of the leases are granted to agricultural producers) that display high rates of unemployment and high proportions of minority groups (e.g. Turkish and Roma minorities).

Objectives: To provide subsidised leasing for the purchase of equipment to entrepreneurs from marginalised groups, thus favouring their social integration.

Intervention type: The provision of finance – leasing in this case – is combined with financial education and business management training. The training component is compulsory and the leased equipment is only received after participants have passed a test assessing their understanding of basic financial and management principles. Ownership of the leased good is attained after full repayment of the lease.

Programme length: It varies depending on the value of the leased equipment.

Description: The JOBS Financial Leasing Project's offer has been comprehensive and flexible. It combines the supply of leasing finance with business support services such as financial education and business management training. Future entrepreneurs must complete 20 hours of training, after which they sit an examination where they have to answer correctly 80% of the questions. However, those who already manage a business can try to pass the test without going through the full training course.

The JOBS Financial Leasing Project caters for both existing and future entrepreneurs. The latter are targeted through the Start-with-Leasing programme. For new entrepreneurs the only condition to receive support is to have a viable business idea that will result into the hiring of at least one additional person. The programme is also tailored to the special needs of Roma entrepreneurs, who receive longer repayment terms and grace periods and are requested a smaller advance payment.

The programme is delivered by 42 business centres and 10 business incubators, which have been set up at local level by local labour offices, municipalities and other public and private-sector organisations. Centres and incubators take the legal status of not-for-profit organisations and are in charge of the purchase of the leased equipment and of the financial education and business development courses.

Results: From 2000 to 2008, 1 985 companies were supported by the scheme through EUR 10.4 million in leasing finance, 34 660 people obtained stable employment, and nearly 53 500 benefitted from training courses. The programme has grown in popularity throughout the 1990s, and business incubators and business centres have become able to generate revenues by leasing equipment to participants.

Lessons for other initiatives: Financial education, together with business development training, should be a key component of programmes that supply finance for entrepreneurs from disadvantaged and under-represented groups; business support services such as training and advice should be delivered both before and during the period of financial support; leasing can be an important component of microfinance programmes, provided that adequate measures are taken to prevent frauds (e.g. public registration of equipment) and intense marketing of clients is undertaken.

Source: <http://goodpracticeroma.ppa.coe.int/en/pdf/110>

CONCLUSIONS

Women, migrant, young and low-educated entrepreneurs experience difficult access to credit and credit conditions. Although cases of open discrimination are possible, this is more often the outgrowth of firm-specific and market-specific factors: e.g. low entrepreneurial and financial literacy skills of the entrepreneur and undercapitalisation or low growth prospects of the business. The mere supply of finance is unlikely to solve alone a condition of multifaceted disadvantage. Programmes financing inclusive entrepreneurship should be aligned with other initiatives supporting entrepreneurial skills and market development skills.

Grants and subsidised credit have proven effective in the past in helping the self-employment of hard-to-reach groups (e.g. the unemployed and the youth), although they are an expensive policy in a time of public budget constraints. Emerging financing

schemes can complement traditional policies. Loan guarantee programmes have been applied in many EU countries (e.g. Italy, France, Denmark, the Netherlands, etc.). However, the main focus of credit guarantee schemes has been on traditional small enterprises, while their ability to reach disadvantaged new entrepreneurs needs be strengthened. This recommendation also applies to microcredit. At the EU level, women and migrants are underrepresented among the clients of MFIs compared to the share they represent in the entrepreneurial population. Targeted microcredit programmes are warranted to ensure that these groups are not excluded from a financing mechanism that is important for the goals of inclusive entrepreneurship.

New Internet-based sources of finance (e.g. crowdfunding and peer-to-peer lending) hold the potential to foster inclusive entrepreneurship mainly in light of the small sums they provide

and the emotional drive that motivate investors. Nonetheless, EU and national legislations ruling these platforms will have to be strengthened to prevent frauds and provide investors with more transparent information on the companies seeking finance.

Finally, supply-side interventions need to be coupled with others that improve the skills of the entrepreneur. Financial education will help disadvantaged entrepreneurs to achieve a better understanding of the credit system and increase their chance to have loan requests approved.

The following recommendations are put forward:

- Monitor the extent to which entrepreneurs from groups disadvantaged in the labour market (e.g. youth, migrant, low-educated) or underrepresented in the entrepreneurial population (e.g. women and seniors) experience more difficult access to finance than mainstream male entrepreneurs.
- Ensure that government-supported loan guarantee programmes and microcredit schemes adequately reach socially

disadvantaged entrepreneurs and, if this is not the case, take remedial action by either setting up special sections in mainstream schemes, or by launching new targeted programmes aimed at disadvantaged entrepreneurs (women and youth entrepreneurs).

- Expect to provide a strong subsidy component to loan guarantee and microcredit programmes that specifically target entrepreneurs from disadvantaged groups.
- Raise awareness among entrepreneurs about the potential of Internet-based financing tools (e.g. crowdfunding and peer-to-peer lending), but also introduce adequate legislation to avoid misuse and protect investors.
- Encourage linkages between community-based tools, such as self-financing groups, and more structured government programmes aimed at strengthening general access to finance for entrepreneurs.
- Combine supply-side policies with improved financial literacy skills amongst disadvantaged entrepreneurs to enhance their chances of obtaining finance in credit markets.

■ GLOSSARY

Basel III – Set of new rules and regulations governing the banking sector introduced in the aftermath of the 2008 global economic crisis and that will become fully operational by 2018. These rules mainly provide for higher capital and liquidity requirements, with the aim of making banks more resilient to future economic crises.

Collateral assets – Assets required of borrowers by lenders to issue a loan. They usually include goods (real estate, vehicles, etc.) that can be seized, totally or partly, by the lender in the event of loan default.

Crowdfunding – A collective transfer of relatively small resources through lending or equity investment into an entrepreneurial project. This is usually done with the help of an Internet platform acting as a virtual meeting point between entrepreneurs and investors.

Factoring – The sale of accounts receivable by an enterprise to a factoring company at a discounted value. It is used to cope with cash-flow emergencies when entrepreneurs prefer receiving a discounted payment immediately rather than await the full payment of receivables later.

Financial education – The process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice develop the skills and confidence to become more aware of financial risks and opportunities to make informed choices, to know where to go for help, and take other effective actions to improve their financial well-being (OECD, 2005).

Islamic Finance – Financing activity in compliance with Sharia law that forbids the charge of interest rates by lenders on borrowers. Lending is not ruled out, but lenders are treated as stakeholders. It has so far been more commonly used by large investment funds than to support entrepreneurs.

Loan guarantee – Commitment by a third party to cover part of the losses related to a loan default. It can be provided by the government and/or by a private business association. It is backed up by a fund acting as collateral.

Leasing – Rental of work-related equipment against a monthly fee. The entrepreneur resorting to leasing may or may not become owner of the equipment at the end of the leasing period, depending on the terms of the contract.

Microcredit – Small-sized loans to borrowers who find it difficult to obtain credit from traditional banks. It consists in small sums generally at higher interest rates than those available at traditional banks to reflect the riskier profile of the borrower. In the EU, the microcredit threshold is set at EUR 25 000.

Overdrafts – Lines of credit by which lending institutions allow borrowers to withdraw beyond their deposits. They have typically a ceiling that reflects the perception of risk that the banks ascribe to borrowers. A very expensive source of external finance, it is nonetheless common among entrepreneurs.

Self-financing groups – Community-based systems in which members make deposits and lend to each other. They are not dependent on external support from philanthropic or financial institutions and lend only up to the limit of the resources they own.

Trade credit – Lenders are not financial institutions but company suppliers, who let buyers pay invoices within an agreed delay period (usually between 30 and 90 days). Entrepreneurs can therefore use part of the revenues to pay for the supply. It is common in retail.

■ FURTHER READING

Molenaar K. (2013), “Financing of Micro, Small and Medium Enterprises for Underrepresented and Socially Disadvantaged Groups”, background paper prepared for the OECD LEED Programme, march 2013.

BIBLIOGRAPHY

Agrawal A., C. Catalini and A. Goldfarb (2011), "The Geography of Crowdfunding", *NBER Working Paper Series*, n.16820, Cambridge, MA.

Alesina A., F. Lotti and P.E. Mistrulli (2013), "Do Women Pay More for Credit? Evidence from Italy", *Journal of the European Economic Association*, vol. 11(s1), 45-66

Amatucci F. and J. Sohl (2004), "Women Entrepreneurs Securing Business Angel Financing: Tales from the Field", *Venture Capital: An International Journal of Entrepreneurial Finance*, vol. 6 (2-3), 181-196.

Atkinson A. and F. Messy (2012), "Measuring Financial Literacy: Results of the OECD/International Network on Financial Education (INFE) Pilot Study", *OECD Working Papers on Finance, Insurance and Private Pensions*, n. 15, Paris.

Avery R., R. Bostic, K. Samolyk (1998), "The Role of Personal Wealth in Small Business Finance", *Journal of Banking & Finance*, Vol. 22, 1019-1061.

Beck T., L. Klapper and J. Mendoza (2010), "The Typology of Partial Credit Guarantee Funds around the World", *Journal of Financial Stability*, Vol. 6(1), 10-25.

Brana S. (2013), "Microcredit: An Answer to the Gender Problem in Funding", *Small Business Economics*, Vol. 40, pp. 87-100.

Caliendo M. (2013), "New Evidence on the Effects of Start-Up Subsidies for the Unemployed", International Conference on Active Labour Market Policies, DARES, Paris, 15 February 2013.

Caliendo M., J. Hogenacker, S. Künn, F. Wießner (2012), "Alte Idee, neues Programm: Der Gründungszuschuss als Nachfolger von Überbrückungsgeld und Ich-AG", *Journal for Labour Market Research*, Vol. 45, No. 2, pp. 99-123.

Caliendo M. and S. Künn (2011), "Start-Up Subsidies for the Unemployed: Long-term Evidence and Effect Heterogeneity", *Journal of Public Economics*, vol. 95(3-4), 311-331.

Columba F., L. Gambacorta and P. Mistrulli (2010), "Mutual Guarantee Institutions and Small Business Finance", *Journal of Financial Stability*, vol. 6(1), 45-54.

Cowling M. (2010), *Economic Evaluation of the Small Firms Loan Guarantee (SFLG) Scheme*, Institute for Employment Studies, Department for Business Innovation and Skills, UK Government, www.bis.gov.uk/files/file54112.doc

Community of Practice on Inclusive Entrepreneurship (COPIE) (undated), *Designing Microfinance Operations in the EU: A Manual on how to Build Microfinance Support Programmes Using the ESF*, http://www.cop-ie.eu/sites/default/files/COPIE_Access_to_Finance_Manual.pdf

De Buysere K., O. Gajda, R. Kleverlaan, D. Mar (2012), A Framework for European Crowdfunding, www.crowdfundingframework.eu

D'Ignazio and C. Menon (2013), "The Causal Effect of Credit Guarantees for SMEs: Evidence from Italy", Bank of Italy Working Paper n. 900.

European Microfinance Network (EMN) (2010), *Overview of the Microcredit Sector in the European Union*, Working Paper N. 6, Fundación Nantik Lum.

European Central Bank (2013), *Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area: October 2012 to March 2013*, April 2013, Brussels.

European Commission (2013a), *Entrepreneurship in the EU and beyond - Flash Eurobarometer 354*, Brussels.

European Commission (2013b), *Implementation of the European Progress Microfinance Facility — 2012*, Brussels

European Commission (2011), *2011 SMEs' Access to Finance Survey*, Brussels.

European Commission (2010), *Entrepreneurship in the EU and beyond - Flash Eurobarometer 283*, Brussels.

Eurostat (2011), "The Proportion of Unsuccessful Loan Applications by SMEs Has Risen with the Economic Crisis", news release 144/2011, 3 October 2011.

Evans D. and B. Jovanovic (1989), "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints", *Journal of Political Economy*, Vol. 97, 808-827.

European Investment Fund (2012), "Progress for Microfinance in Europe", Working Paper 2012/13, Luxembourg.

European Investment Fund (2009), "Microfinance in Europe: A Market Overview", Working Paper 2009/01, Luxembourg.

Fairlie R. (2010), "Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets", Testimony to the U.S. Senate Committee on Small Business and Entrepreneurship, 15 April 2010.

Green A. (2005), "Combining Strengths: Synergies between Cluster Development and Microfinance", SME Technical Working Paper n. 14, UNIDO, Vienna.

Harrison R. and C. Mason (2007), "Does Gender Matter? Women Business Angels and the Supply of Entrepreneurial Finance", *Entrepreneurship Theory and Practice*, vol. 31(3), 445-472.

Kon, Y. and D. Storey (2003), "A Theory of Discouraged Borrowers", *Small Business Economics*, Vol. 21(1), 37-49.

Ledgerwood J. (1998), *Microfinance Handbook: An Institutional and Financial Perspective*, World Bank, Washington DC.

Lelarge C., D. Sraer and D. Thesmar (2010), "Entrepreneurship and Credit Constraints: Evidence from a French Loan Guarantee Programme", in J. Lerner and A. Schoar (eds.), *International Differences in Entrepreneurship*, 243-73, National Bureau of Economic Research.

Mason C. and J. Kwok (2010), "Investment Readiness Programmes and Access to Finance: A Critical Review of Design Issues", *Local Economy*, vol. 25(4), 269-92.

Muravyev A., D. Schäfer, O. Talavera (2009), "Entrepreneurs' Gender and Financial Constraints: Evidence from International Data", *Journal of Comparative Economics*, Vol. 37 (2), 270-86.

OECD (forthcoming), *Financing SMEs and Entrepreneurs 2013: An OECD Scoreboard*, Paris.

OECD (2013), "SMEs and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in Supporting Finance for Small and Medium-Sized Enterprises", unpublished report. (www.oecd.org/cfe/sme)

OECD (2012a), *Financing SMEs and Entrepreneurs 2012: An OECD Scoreboard*, Paris.

OECD (2012b), *OECD/INFE High-Level Principles on National Strategies for Financial Education*, Paris.

OECD (2011), *Financing High-Growth Firms: The Role of Angel Investors*, Paris.

OECD (2005), *Recommendations on Principles and Good Practices for Financial Education and Awareness*, Paris.

OECD/EC (2013), *The Missing Entrepreneurs: Policies for Inclusive Entrepreneurship in Europe*, OECD Publishing, Paris.

OECD/EC (2012a) *Entrepreneurial Activities in Europe - Policy Brief on Youth Entrepreneurship*, Publications Office of the European Union, Luxembourg.

OECD/EC (2012b) *Entrepreneurial Activities in Europe - Policy Brief on Senior Entrepreneurship*, Publications Office of the European Union, Luxembourg.

Pew Forum (2011), *The Future of the Global Muslim Population*, Washington DC.

Saxenian A. L. (2006), *The New Argonauts: Regional Advantage in a Global Economy*, Harvard University Press, Cambridge, MA.

Stressman Foundation (2012), "Intrinsic Barriers of Islamic Finance: Sharia Scholars and the Low Muslim Income", Löbdergraben, Germany.

Underwood T. (2006), "Overview of the Microcredit Sector in Europe: 2004-2005", European Microfinance Network Working Paper n. 4.

OECD/European Commission

**Policy Brief on Access to Business Start-up Finance for Inclusive Entrepreneurship –
Entrepreneurial Activities in Europe**

Luxembourg: Publications Office of the European Union

2014 — 28 pp. — 21 × 29.7 cm

European Commission
ISBN 978-92-79-33516-7

This policy brief was produced by the OECD and the European Commission to explore barriers in access to finance by social groups who are disadvantaged or under-represented in entrepreneurship and to describe policies which can address these barriers. It presents data on the extent to which entrepreneurs from disadvantaged groups obtain external finance. It then sets out the traditional policy instruments of grants and soft loans together with newer and emerging policies such as loan guarantees, microcredit, crowdfunding, business angels and Islamic finance. In addition to supply-side instruments, the role of financial education is also explained. Finally, the brief gives a number of examples of policy approaches that have been successful in European Union Member States.

This policy brief is part of a series of documents produced by the OECD and the European Commission on inclusive entrepreneurship. The series includes policy briefs on youth entrepreneurship, senior entrepreneurship, social entrepreneurship, evaluation of inclusive entrepreneurship programmes, access to business start-up finance for inclusive entrepreneurship and entrepreneurship by the disabled as well as a report on 'The Missing Entrepreneurs'. All these documents are available in English, French and German. They are available at <http://www.oecd.org/cfe/leed/inclusive-entrepreneurship.htm>.

HOW TO OBTAIN EU PUBLICATIONS

Free publications:

- one copy:
via EU Bookshop (<http://bookshop.europa.eu>);
- more than one copy or posters/maps:
from the European Union's representations (http://ec.europa.eu/represent_en.htm);
from the delegations in non-EU countries (http://eeas.europa.eu/delegations/index_en.htm);
by contacting the Europe Direct service (http://europa.eu/eurodirect/index_en.htm) or
calling 00 800 6 7 8 9 10 11 (freephone number from anywhere in the EU) (*).

(*) The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you).

Priced publications:

- via EU Bookshop (<http://bookshop.europa.eu>).

Priced subscriptions:

- via one of the sales agents of the Publications Office of the European Union
(http://publications.europa.eu/others/agents/index_en.htm).

HOW TO OBTAIN OECD PUBLICATIONS

- The OECD library: <http://www.oecd-ilibrary.org>
- The OECD Bookshop online: <http://www.oecdbookshop.org>

This Policy Brief was prepared by the LEED (Local Economic and Employment Development) Programme of the OECD (Organisation for Economic Co-operation and Development) with the financial support of the European Commission, Directorate-General for Employment, Social Affairs and Inclusion.

