



Handbook of Microcredit in Europe

**Social Inclusion through
Microenterprise Development**

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6 Microcredit in Portugal

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1 National context

Portugal is today considered a developed country, albeit with levels of well-being still somewhat removed from the average of other Western European countries. There has been remarkable progress in the past decades, but it has been accompanied by an increase in economic and social instability hardly permissible in a modern and competitive society capable of generating progress. This is not only the result of internal dynamics but is also due to structural changes in the way economies work globally. One of the major effects of these recent structural changes has been the increase in the unemployment rate. In a relatively short time, Portugal changed from being one of the countries in the EU with the lowest unemployment rate to one whose rate is above average.

This accelerated change has caught most of the international community by surprise. Capital, goods and people move at a speed and complexity which makes it very difficult to carry out medium and long-term projections. Political maps are drawn and re-drawn as countless ethnical and political groups emerge to make new claims and demand new territories. These changes cause social tension that development policies are incapable of controlling. Simultaneously, it has been assumed that by applying the same economic principles that work for market economies, social questions will solve themselves; dynamic and functional markets would not only generate wealth but would solve people's problems with levels of well-being. Every analysis that has been carried out leads us to conclude that this is a profound mistake and to the realization of its catastrophic consequences.

Both the silent impoverishment of millions of people pushed to the fringes of economy, and the shocking scenes of open war that is destroying whole countries are a clear demonstration of the high price the whole world is paying for having placed social issues on hold. On the other hand, we are witnessing an unbridled growth of the black economy: the 'informal' sector has been the only option for families wanting to avoid greater poverty. It is a spontaneous survival response for all those who have no other way out and who still have the will to react and the imagination to find a solution.

In Portugal, a European Commission study (2006) revealed that around 20 per cent of the population (2 000 000 people) are at risk of poverty and

clearly seek a better life. Part of the solution could involve a little support by providing them with access to a small loan and allowing them to create a small business or company and consequently their own employment. The traditional banking system has always marginalized the poor, only granting credit to people with property or collateral, thus perpetuating a vicious circle; we cannot solve the poverty problem by applying the same theory that originated the problem in the first place. The poor are considered to be bad payers, with no entrepreneurial spirit and lazy. The experience of the institutions recently created in Portugal, who specialize in microcredit for those excluded from the traditional banking system, confirmed what has also been happening in other countries, that on average, beneficiaries of microcredit default much less on their loans than other economic agents, the survival rate of these microenterprises is high and their productivity is also high.

2 The origin of microfinance in Portugal

Microfinancing experiments, driven by social solidarity usually at a local level, have a long history in Portugal, dating back to the fifteenth century with the *Misericórdias* (Portuguese charity organization). In the second half of the sixteenth century there was the 'Common Granary' experience in which seeds were lent to farmers in years of poorer yields. Reimbursement, namely of interest, was also made in commodities. In the second half of the nineteenth century, the work carried out by the *Misericórdias* stimulated the creation of agricultural and industrial credit institutions, leading to the birth of the *Caixas de Crédito Agrícola Mútuo* in the beginning of the twentieth century. As small local banks, the *Caixas de Crédito Agrícola* played, and still play, a very important role in supporting small farmers, granting them small loans to face the challenges inherent in their activity. Finally, at the end of the 1970s, *Caritas*, a humanitarian organization of the Catholic Church, provided small loans to Portuguese people returning from the former colonies to help with their social and economic integration.

Unfortunately, most of the dynamics of these and other components of the so-called 'Third Sector' that existed in the first quarter of the twentieth century were suppressed by the long-lasting authoritarian regime that governed the country from 1926 until 1974. So, it was after democracy was restored in the country and the initial period when most of the focus in the fight against poverty was placed in the public sector, that the time came for the 'Third Sector' to take the lead in promoting microfinance and other forms of support to the excluded population. More recently, and following the strong boost given to microcredit by Muhammad Yunus, in Bangladesh in the late 1970s, new forms of microcredit emerged in Portugal, the most relevant of which being undertaken by *Associação Nacional de Direito ao*

Crédito (ANDC), in 1998, with others following later. Thus these are the foundations for the construction of a microfinance system in Portugal.

3 Main actors within the microfinance sector in Portugal

In Portugal, it is still hard to speak of a consistently structured microfinance activity. The microfinance activity that it has been possible to implement has focused on microcredit, leaving aside all other microfinance products and services. As previously mentioned, the organization which first promoted and most consistently developed microcredit in Portugal was ANDC. ANDC is a microcredit non-profit association created in 1998, which began its field activity in May 1999. It aimed to allow those who have been excluded from the traditional banking sector, and who have an idea and a project to create their own job or their own microenterprise, to have access to credit (microcredit). ANDC does not grant loans directly, since this is not allowed by Portuguese law.

Since 1999, the architecture of the microcredit system in Portugal has been based on the following key organizations and partnerships:

- a. ANDC, playing the following roles:
 - raising awareness in the Portuguese society at large about the relevance of microfinance as an effective means to fight against poverty;
 - providing advice and technical assistance to those who want to apply for microcredit;
 - presenting those applicants to the banks which provide the loans and remaining as last resort guarantor of those loans, in the event of default;
- b. Some banks (Millennium BCP, Banco Espírito Santo and Caixa Geral de Depósitos) are willing to provide microcredit to the applicants recommended by ANDC at preferential interest rates;
- c. A public institute from the Ministry of Labour (Instituto do Emprego e Formação Profissional) whose main role has been to finance most of the operating costs of ANDC, based on the assumption that ANDC promotes the creation of employment.

As a non-profit association, ANDC today has around 320 members who contribute to a guarantee fund on top of their obligatory contributions. Members participate voluntarily in the activities of the Association in areas such as corporate bodies, credit committees, legal support, monitoring and mobilization of micro-entrepreneurs promotion, administrative support, and so on. ANDC's qualified staff is divided into two groups: the management/back office group and the operations group. The back

office is composed of a Secretary General, one Secretary in Lisbon and another in Porto. There is also a group of volunteer workers who give support to this area. The operations team comprises one coordinator and 11 microcredit agents: two in Porto, five in Lisbon, one in the Algarve and the remaining covering the other parts of the country. ANDC has five volunteers on its Board of Directors, three volunteers on the General Assembly Board and three volunteers on the Auditors Board. There are also four Credit Committees (three in Lisbon and one in Porto) which are composed of five volunteer members each.

ANDC provides a number of services which involve the setting up and monitoring of business projects. The project setting-up stage consists of several interviews with the potential micro-entrepreneur with the purpose of helping him/her to build the business project and evaluate the feasibility of his/her idea. This stage ends with the preparation of the business plan and subsequent presentation to a credit committee which decides whether or not the application should be submitted to the bank. Once the application is submitted to the bank and the loan is approved, ANDC carries out follow-up work, in particular helping applicants overcome any problems that may arise along the way. A team of volunteer workers offer assistance in certain specific areas.

Following the partnership experience already established with ANDC, Millennium BCP, one of the largest commercial banks, decided, at the end of 2005, to create its own credit line. This is mainly aimed at an audience that, due to the more restrictive criteria, may not be considered excluded, but who still need support in spite of above-average academic qualifications and training. For this purpose Millennium BCP has opened branches in Braga, Lisbon and Porto. Besides this new type of microcredit the bank is maintaining its partnership with ANDC to provide microcredit to the applicants recommended by this organization, as has been happening since 1999.

Santa Casa da Misericórdia de Lisboa also created a microcredit bureau at the beginning of 2006, by means of a protocol signed with the financial institution Montepio Geral, to work with issues that arise in the communities within Lisbon, which they assist with social support services and subsidies. There is also word that microcredit activity is being implemented by some Caixas de Crédito Agrícola Mútuas in partnership with Superação SPA Consultoria, a project consultancy company.

4 Model of microcredit granting in Portugal: general description of the model

ANDC targets people who are socially and economically excluded and who do not have access to traditional bank credit. ANDC has only one

type of loan, with a maximum amount of €10 000 and the minimum of €1 000. However, the first block of the loan cannot exceed €7 000, and only after a year of activity can a second one, to a maximum of €3 000, be made available after an evaluation of the business. At the moment, ANDC has provided more than 800 loans for a total of nearly €3 400 000. These projects led to the creation of more than 930 new jobs. During 2006, ANDC granted 122 loans for a total of €524 000. A recent study (Mendes et al., 2007) concluded that these loans have been effective in the fight against poverty because on average, they increased the annual income of the applicants by €3 740 in a country where the 'at-risk-of-poverty' income threshold for a household with two adults and two dependent children is €9 864 (European Commission, 2006).

ANDC also aims to raise awareness and promote the concept of micro-credit in Portugal. This is being achieved through the media, by meetings and conferences and also by publishing a regular newsletter, *Noticias do Micro Credito* (Microcredit News). In addition ANDC undertakes:

- intermediary work between promoters and financial institutions;
- monitoring and support to the micro-entrepreneurs after financing has been granted and during consolidation of the project.

Both Millennium BCP and Santa Casa da Misericórdia have set their credit line limits at €15 000 while Superação SPA Consultoria has a much higher limit of €25 000.

In every situation there is a microcredit model which, with the exception of Millennium BCP, has on one side the institutions that promote and monitor the development of projects (ANDC, Santa Casa da Misericórdia de Lisboa) and on the other side the financial institutions whose main role, by means of protocols signed with the former institutions, is to supply credit to promoters. The third partner in the system is the public sector, whose main role is to finance the operating costs of those organizations such as ANDC and whose main role is to reduce the transaction costs preventing the poor population from accessing the existing banking system.

5 Target groups in Portugal

The target groups are approximately the same for all the microcredit projects mentioned. In ANDC's case a solution is sought to the difficulty of accessing regular credit on the part of people who normally live on the fringes of society, provided they are in possession of a sustainable investment project. Potential clients would include those who are unemployed, who have never held a job but who have skills, or even with people who have a job but who are at risk of losing it. Other characteristics identified

in a recent study (Mendes et al., 2007) covering the period from 1999 to the end of 2006, found that 52.8 per cent were women and 76.1 per cent were 45 years old or younger.

Millennium BCP's microcredit operation is designed to support entrepreneurship and fight social exclusion, having as its main beneficiaries unemployed people, family-run microenterprises, young graduates, immigrants and pensioners. Through microcredit, Millennium BCP finances and promotes people and microenterprises with viable entrepreneurial initiatives who otherwise, would have no access to the financial instruments traditionally made available by banks.

In the case of Santa Casa da Misericórdia de Lisboa (SCML), the objective is to provide financing through microcredit operations for small business projects identified by SCML, for the purpose of integrating the respective promoters into a work culture and to improve social cohesion. The conception and preparation of these business projects, the promotion and development of the entrepreneurial initiative, the setting up of the credit process, its concession and the support and monitoring of the people as they develop their enterprises, are all tasks promoted by SCML. Microcredit applicants must be between 18 and 65 years old, must reside in the city of Lisbon and have a limited family income.

The microcredit system promoted by SPA and the Caixas de Crédito Agrícola Mútuo aims to finance local entrepreneurial initiatives, self-employment and the creation of companies by people who are unemployed, who hold precarious jobs or who are looking for a first job.

6 Financial terms and conditions

Interest rate

The interest rate used for microcredit contracts promoted by ANDC is Euribor (6 to 9 months) plus a spread of 2 per cent, in the cases of Caixa Geral de Depósitos and Millennium BCP, and a spread of 3 per cent in the case of Banco Espírito Santo. The microcredit product as developed exclusively by Millennium BCP uses a variable interest rate depending on the risk presented by the promoter. The other two microcredit initiatives use preferential rates equivalent to those practised by the ANDC protocols.

Grace period, amount and others

The grace period varies among the various initiatives but is usually kept within the 0 to 6 months range. In the case of ANDC the grace period is usually 3 months and the tendency is to limit it to this period. In general, collateral is not needed but personal guarantees are required to cover part of the capital involved. In the case of ANDC, a guarantor responsible for

20 per cent of the capital is required, which together with the capital collateral has the purpose of providing the promoter with someone who may act as counsellor during the ups and downs of their project development. Repayment periods vary between a maximum of 36 to 48 months and are carried out in monthly instalments.

Main business services provided

It has previously been pointed out that in Portugal, microcredit institutions are not permitted to carry out credit operations or to accept deposits. This is the reason why they do not handle the credit contract side of the microcredit process. For the same reason, they are not authorized to supply other microfinance products. There is no information as to the relevance they may have in the everyday operations of financial institutions, although that is not to say that they do not exist in certain cases, namely under Millennium BCP's specific project. Utilizing Mendes et al. (2007), there are some indicators of what has been achieved:

- 780 loans;
- €3 530 000 of loans;
- average loan of €4548;
- 970 jobs created;
- 91.8 per cent of the total amount of loans outstanding on 1 January 2007, reimbursed;
- increase of €3740 in annual household income;
- survival rate of microfirms funded by microcredit: 69 per cent, well above the national average which is 47.6 per cent for firms with 3 years' trading or more;
- average cost (for ANDC) per loan, in 2005: €2734.

7 Other financial products for inclusion

It is not easy to say that there are, in Portugal, other financial products designed to promote inclusion. Indirectly, there are subsidy-type schemes that may be considered as such, sponsored by the Ministry of Labour and Social Welfare. There is a first category designed to promote inclusion directly: the 'Social Inclusion Income', a subsidy granted monthly to families in a serious economic and social situation, created to provide sustenance and simultaneously to produce incentives so that family members may find paths for inclusion (school attendance for children in care and job-seeking). In a second category, we may include a set of policy measures designed to protect employment operating under the supervision of IEFP (Employment and Vocational Training Institute). These include unemployment benefit (in various forms), granted to workers who

are unemployed and who have contributed in the past to the National Welfare System. We can then find a wide range of options to promote self-employment or the creation of businesses (employment projects promoted by the beneficiaries of unemployment benefits, Local Employment Initiatives and Company Incubators), to support immigrants, people with disabilities and other specific groups.

8 Government support

Support has been granted to ANDC to help finance part of its operational activity in proportion to the number of microcredit projects developed. This financial assistance is justified because ANDC does not charge promoters for any transaction costs and because, since the government grants companies, in certain circumstances, with subsidies in proportion to the number of jobs created, it was accepted that ANDC's activity could similarly be regarded as a job-promoting activity.

9 Regulation: fiscal treatment, regulation of microenterprises, and so on

In Portugal, there is no specific legal framework designed for micro-entrepreneurs. There are only financial and fiscal regulations aimed at small and medium enterprises (SMEs).

ANDC has, for many years, been stressing the importance of creating a specific statute for the micro-entrepreneur, arguing that this should incorporate in a single document the existing regulations that may be applied to micro-entrepreneurs and provide a better understanding of the present omissions, while identifying policy measures that are lacking and need implementation. ANDC has pointed out that the type of micro-entrepreneur they work with has specific characteristics which should be taken into account within the legal framework. The first months of the enterprise's life, in particular, should be regarded as a process of vocational training at no cost to the government. Consequently, those who, justifiably, have no success with their enterprise should be considered as unemployed and thus be entitled to unemployment benefit. For the same reason, microenterprises should benefit from more favourable fiscal measures than companies that do not promote inclusion or that do not have inherent inclusion programmes.

10 Financial and operational sustainability

When analysed from a strictly financial perspective, the microcredit activity in Portugal has not been conducted in a sustainable way. The Millennium BCP project is, perhaps, the only exception since it is the only one to apply non-preferential interest rates. Lack of financial sustainability does not mean the absence of economic and financial

sustainability. In the case of ANDC, in particular, this sustainability is obtained through the support of volunteers, member contributions and transfers from the government. It is not fair to assume that this results in hidden deficiencies. A recent study promoted by the Ministry of Labour and Social Welfare revealed that the work carried out by microcredit institutions is as efficient, if not more so, than that carried out by other similar institutions or with similar objectives, in Portugal and abroad (Mendes et al., 2007).

As in many other countries for similar organizations, a very high percentage of the ANDC's costs is supported by donors. The difference lies in the fact that for ANDC, public funding donations represent a very high share: the funds received from the Ministry of Labour total 91 per cent of the total expenditures of ANDC in 2004 and 2005. So the share of voluntary private contributions is still very small. This is not the case if we take into account what has been and continues to be the major resource on which ANDC has lived since its creation: the voluntary work of all those who have supported ANDC in different roles.

11 Challenges for the sector in Portugal

As previously pointed out, there is great market potential for the development of microcredit in Portugal. Any financial, administrative and institutional support that can be channelled to microcredit activities should not be regarded solely as an expense, but rather as a highly profitable investment in the near future. Consequently, there are three main challenges ahead:

1. The creation of a greater number of microcredit institutions; it is important that they are adequately sized with a strong participation from the civil society while assuming their citizenship responsibilities.
2. The mobilization and the raising of awareness on the part of social solidarity institutions working with the excluded, regarding the microcredit option for those living in precarious conditions who nevertheless, have the will and ability to be independent, autonomous and create their own business.
3. The raising of awareness of public authorities about the importance of work carried out on ethical finance. To create the necessary conditions for the introduction of alterations to the Financial Institutions Regulation that may, in the future and under specific conditions, allow the development of ethical finance institutions, a development that will bring financial, economic and social advantages to public administration.

Note

* Expert: Américo Mendes.

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