



from
exclusion
to
inclusion
through
microfinance

critical issues

what is microfinance?

Microfinance means offering financially excluded people (on low incomes) and microentrepreneurs basic financial services, like credit, savings and insurance. These services give people an opportunity to protect their families against financial risks and invest in new or existing economic initiatives. Such services are provided by specialised institutions that can be classified as banks (cooperative, commercial, microfinance or savings banks) and non-banks (financial cooperatives, non-profit companies and NGOs).

All categories of institutions seek to use the market approach to solve the problems of financial exclusion, while in many cases non-banks provide additional non-financial support services for their clients.

Microfinance providers can also be categorised by the different target groups they reach: bankable and non-bankable clients. The bankable group includes traditional start-ups and established microenterprises, while the non-bankable group reaches mainly financially excluded, low-income people.

As far as credit is concerned, the loan amounts are typically very small. However, it is within the context of the EU they can reach up to €25,000 depending on the target group and type of activities.

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summary

Key recommendations for policy makers

1. Recognise that microfinance is a key tool for increasing employment and moving people out of poverty, in that it fights social and financial exclusion. A favourable EU policy environment will have a significant impact across the whole of Europe.
2. Recognise that microfinance is broader than the provision of credit. It includes a range of other financial services, such as savings, insurance and leasing. However, other non-financial services such as Business Development Services (BDS) and financial literacy are needed to fight all aspects of social and financial exclusion. Support for this will significantly enhance the operations of microfinance institutions (MFIs), which will in turn increase their impact, accelerating the inclusion process.
3. Work to improve the microfinance policy environment in their own country. In addition, encourage co-operation between the EU member countries, (especially between those in the East and West), NGOs and private corporations to harness all in the effort to combat social and financial exclusion.

Key recommendations for practitioners

1. Develop a wide range of services and products relevant to the needs of people on low incomes and microentrepreneurs.
2. Develop their organisation's capacity to understand and use indicators in established and emerging assessment frameworks.
3. Create a culture of innovation which can respond to the changing needs of the market.

Key recommendations for networks

1. Promote the creation of a favourable microfinance environment at EU and member state levels.
2. Develop partnerships with EU member states, NGOs and private corporations which can strengthen work towards the shared goals of social and financial inclusion.
3. Promote the concept and develop the understanding of microfinance among stakeholders and a more general audience.

introduction

Microfinance is recognised worldwide as an effective tool in fighting social and financial exclusion and poverty. In Europe the development of the sector started in the 90's and has not progressed at the same pace in individual countries. A rapid and strong development in the countries of Eastern Europe (including some of the new EU Member States) has contrasted with slower, patchier growth in Western Europe. Networks such as Microfinance Centre (MFC), European Microfinance Network (EMN) and the Community Development Finance Association (**cdfa**) have been involved in creating good practice tailored to the countries in which they operate. To date, little knowledge transfer between members of these networks has occurred, and the project was designed to address this issue.

The project aimed to combine the various experiences of the three networks in overcoming social and financial exclusion in the East and West. The identification of key constraints and opportunities served as the basis for policy formulation and recommendations that will enable building more inclusive welfare and financial systems.

The project's specific objectives were to:

- Raise awareness of the benefits of microfinance amongst policy makers.
- Increase learning in respect of approaches and tools existing among microfinance practitioners (in the EU and the newly accessing countries) that allow them to effectively respond to the financial and non-financial needs of socially and financially excluded people.
- Identify key constraints and opportunities in reaching out to socially and financially excluded people.
- Develop a model for an East-West platform for information and knowledge exchange.

The methodology was based on four working groups comprised of members of each network. Each working group's research culminated in a report:

Report 1

Social and financial exclusion map looked into how financial exclusion ties into social exclusion in the East and in the West.

Report 2

Key constraints, challenges and policy recommendations explored which policy measures are effective in the East and West respectively by developing a specific tool, the eScorecard, to measure such policies.

Report 3

Benchmarks and performance measurement, worked on the definition of indicators for the measurement of microfinance programmes.

Report 4

Innovative approaches and products in combating financial exclusion focused on such aspects as BDS, technical assistance and product development and innovation.

This report focuses on the critical issues identified by the four working groups. The recommendations that follow are synthesised from their work. They are aimed at three target groups: policy makers, practitioners and networks. They necessarily overlap because they are all working towards the same goal: combating social and financial exclusion and improving the wealth of people across the whole of the European Union.

The full reports from each working group are available on the CD inside this document. An overview of each report is annexed to this publication.

financial exclusion: cause and consequence of social exclusion

Whilst the economic situations differ significantly, microfinance is needed in Western as well as Eastern Europe. People in every country throughout Europe are experiencing social and financial exclusion; microfinance is a key tool in combating this disenfranchisement.

Social exclusion is a complex phenomenon; dynamic and multi-dimensional, linking various aspects of life from which people are excluded. There is no single agreed definition, mainly due to the difficulty in defining the ideal, referenced state of inclusion.

Social exclusion refers to marginalisation from employment, income, social networks such as family, neighbourhood and community, decision making and from an adequate quality of life. The problems of social exclusion are frequently linked and mutually reinforcing. It is often difficult to disentangle the causes and consequences.

The risk of social exclusion is highest for those with multiple disadvantages. However, unemployment is the major factor contributing to social exclusion, since employment and job security promise an income to satisfy basic needs and provide social integration and social identity at the same time.

Although unemployment is the major factor, if the socially excluded groups are disaggregated by gender, age, geographic location, ethnicity and immigration status, other key elements may emerge. Social exclusion is strongly related to poverty, but these two concepts must be defined separately. To be poor does not necessarily mean being socially excluded, but it increases the chances of such an outcome.

Financial exclusion can be described as the inability of individuals, households or groups to access necessary financial services in an appropriate form. Exclusion can come about as a result of problems with access, prices, marketing, financial literacy or self-exclusion in response to negative experiences or perceptions. In such a context financial exclusion is either a cause or a consequence of social exclusion, or both.

The recommendations that follow have been developed from the findings of the project and are aimed at three key groups: policy makers, practitioners and networks. This is because all three constituencies have a role to play in improving economic and social opportunities across Europe.

Recommendations for policy makers

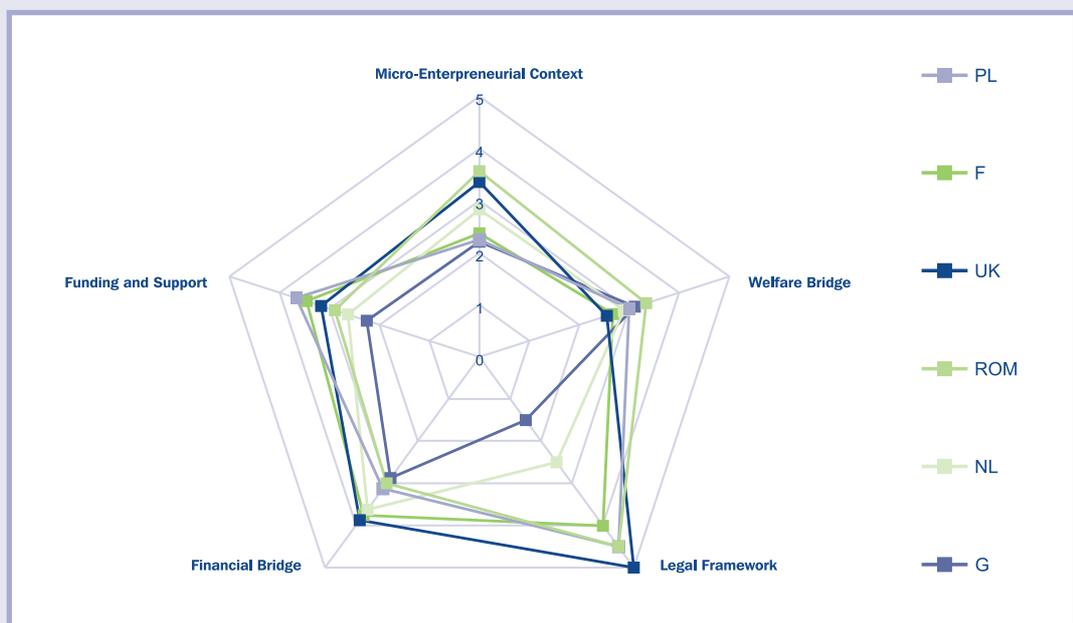
1. **Recognise that microfinance is a key tool for increasing employment and moving people out of poverty in that it fights social and financial exclusion. A favourable EU policy environment will have a significant impact across the whole of Europe.**

Financial and social exclusion exist in every country throughout Europe and both can be tackled by the provision of microfinance. Creating a favourable policy environment which allows microfinance to grow and thrive will enable more people to be both financially and socially included and so improve the overall wealth of the European Community. Our study has indicated that the following are key areas for policy development:

- Supporting the improvement of performance through the understanding, development and use of indicators. Such indicators might be at transnational or country level, but should be used to assess the progress of MFIs. Report 3 looks at this in more detail and proposes an outline framework based on a series of social and financial indicators.
- Creating appropriate legal and regulatory frameworks that can play a part in the growth of a range of institutional models for MFIs (such as financial NGOs and co-operatives, microfinance banks). Using the eScorecard to measure progress in policy developments as described in report 2 (see table 1 and report 2).
- Designing incentives to encourage private sector investment in microfinance development. These could include tax breaks such as Community Investment Tax Relief as mentioned in report 2.
- Acknowledging microenterprise as a priority area for social inclusion. It should be supported through appropriate policies such as access to finance, well-targeted business support and the reduction of legal and regulatory barriers to start-up and growth.

Table 1 - eScorecard

This scorecard, which is a tool to assess the microfinance/social inclusion environment in each country, will enable policy makers to evaluate their progress in key areas such as: micro-entrepreneurial context, welfare bridge, legal framework, financial bridge, and funding and support. It will increase their awareness of the policy environment in other countries and help to develop a model for exchange of information and knowledge among member states.



recommendations

- 2. Recognise that microfinance is broader than the provision of credit. It includes a range of other financial services, such as savings, insurance and leasing. However, other non-financial services such as BDS and financial literacy are needed to fight all aspects of social and financial exclusion. Support for this will significantly enhance the operations of microfinance institutions (MFIs), which will in turn increase their impact, accelerating the inclusion process.**

While access to credit is crucial for the socially and financially excluded, a package of other services and products needs to be in place to ensure the credit has maximum impact. MFIs need to be supported in the development of these. Activities under this recommendation should include:

- Supporting the development of innovative products and services which allows for greater penetration by and/or greater efficiencies of MFIs. Report 4 provides a range of practical and successful examples (see table 2).
- Supporting the technical assistance provided by MFIs to low income people and acknowledging that this is a necessary but expensive activity which may not be covered by the income generated by a MFI.
- Recognising that different countries will need to create different products, depending on the particular need of those that are socially and financially excluded in those countries.

- 3. Work to improve co-operation between the EU member countries, NGOs and private corporations to harness all in the effort to tackle social and financial exclusion.**

Through this project we have gained a greater understanding of the practice of microfinance throughout Europe. With this in mind, we have strengthened our activities which, in turn, has developed our own practice and reach. We would like to see this co-operation further developed and extended to include more actors. Key activities under this recommendation could be:

- Further support for collaboration between MFIs in member countries through the relevant networks.
- Support the flow of private finance into MFIs.
- Within the EU, strengthen the microfinance expert group and support the development of a Microfinance Action Plan.

Recommendations for practitioners

- 1. Develop a wide range of services and products to support clients.**

Some MFIs are taking an entrepreneurial approach to their work and developing their products and services. As innovation in products and services is crucial to market penetration, all MFIs must seek to adopt such an approach. Key activities here are:

- Ensuring the development of new products is a continuous process.
- Regularly assessing the effectiveness of existing products.
- Creating efficiencies in all areas of operation.

2. *Develop the capacity to understand and use indicators in assessment frameworks.*

Assessment frameworks will become increasingly important as MFIs mature and develop. Such frameworks will be used by stakeholders (including funders and investors) to assess the performance of an MFI. It is therefore vital that MFIs develop their capacity to understand and use indicators in the assessment framework. Report 3 looks at how these frameworks can be used. Key activities here could include:

- Becoming members of national/regional networks which have information on assessment frameworks and can provide support to members in using them.
- Ensuring all staff have their on-going development needs met in line with the assessment framework.
- Ensuring boards are supportive of the assessment framework. They must understand its importance, and the need to communicate clearly to stakeholders the performance of their MFI. An efficient management information system is vital to this process.

3. *Create a culture of innovation which can respond to the changing needs of the market.*

The dynamic nature of economic development means that the demographic of the financially and socially excluded is likely to change at varying rates from country to country. In order to ensure they are servicing the correct market, MFIs must be flexible enough to adapt to their own changing economic environment. Key activities here could include:

- Innovating new products and services which respond to market needs (see example below).
- Regularly assessing their services and products to ensure they are relevant to the needs of their market.
- Creating partnerships with the private sector that encourage scale and growth.

Recommendations for networks

1. *Promote the creation of a favourable microfinance environment at EU and member state levels.*

Networks provide important services to their members. This includes ensuring they are represented in national/regional public policy arenas. The creation of a favourable microfinance environment at EU and member state levels will be vital to the future growth of the sector. Activities here could include:

- Regular meetings between networks to ensure that there is a common approach to policy development and measuring progress using the eScorecard.
- Facilitating country-level policy development.
- Strengthening the specific microfinance expert group within the EU infrastructure.
- Working towards an assessment framework, which is understood by stakeholders across Europe.

2. *Develop partnerships with EU member states, NGOs and private corporations which can strengthen work towards the shared goals of social and financial inclusion.*

recommendations

Networks are in a unique position as they can broker relationships between members and external non-profit partners as well as with EU policy makers and private corporations. Such relationships strengthen activities and help MFIs grow strong and improve their reach. Activities here could include:

- Developing the capacity of their members to meet performance frameworks and innovate new products and services.
- Ensuring members are updated about activities in other networks.
- Inviting people from other networks/member states/NGOs/corporations to address meetings, seminars and conferences to progress the work of social and financial inclusion.

3. *Promote the concept and develop the understanding of microfinance among stakeholders and a more general audience.*

Networks are well placed to promote the concept and develop the understanding of microfinance to a wide audience. The more that people know and understand microfinance, the better its chances of growing and surviving into the future. Activities here could include:

- Ensuring that a bank of case studies is kept and placed in relevant media, including specialist and mainstream arenas.
- Seeking new avenues in which to promote microfinance, including seminars, conferences and websites of potential partners.
- Writing letters/articles promoting microfinance to mainstream media and other publications.

Table 2 - Example of innovation

Street UK, a Community Development Finance Institution (CDFI), offers the first UK MFI leasing scheme providing enterprise finance for capital equipment at reduced risk for the lender and client. Leasing is available on certain types of second-hand equipment. Lease rental assets sit on the Street UK balance sheet as fixed assets, and are depreciated over the lifetime of the lease. This product can be offered to small scale entrepreneurs unable to access finance from mainstream sources and other CDFIs, who might wish to offer leases to their clients.

Lincolnshire Community Business Development Finance Initiative has an arrangement with Street UK under which it can issue loans. This enables their clients to lease equipment (mostly vans) which they could not afford to buy because they have poor credit ratings. The MFI can therefore secure its lending on the capital item, and offer the client a 2% discount as a result. Ten leases totalling £45,000 (€66,800) were approved in the first year.

The recommendations above are synthesised from the four project reports and are designed to interlink and ensure all parties are working together in the most appropriate way. They provide a package of activities which, if implemented in a timely and appropriate manner, will ensure that microfinance achieves its potential by creating social and financial inclusion throughout the whole of the European Union.

overview

Report 1: Social and financial exclusion map

Background

The fight against social exclusion has been a major concern of EU policy since the early 1990s. Unemployment is the major factor contributing to social exclusion as employment and job security promises an income to satisfy basic needs and provides social integration and identity. The causes of unemployment in Eastern and Western Europe are linked to restructuring and shifts in the economy, especially significant in Eastern Europe during the 1990s. Since then, microfinance programmes in the EU have been addressing social and financial exclusion by enabling the unemployed to gain access to microloans of €25,000 or less for self-employment and microenterprise creation.

Objective

The objective of working group 1 was to develop a 'social and financial exclusion map' outlining how microfinance institutions define and respond to social and financial exclusion in the West and East of Europe and identifying good practices which can be exchanged between microfinance providers in both parts of Europe.

Outcomes

The mapping exercise brought together the 2005 data of 505 microfinance organisations in the European Union. In 2005, Western European organisations reached 16,000 entrepreneurs, disbursing microloans worth €158,000,000. In Eastern Europe, market size measured by gross loan portfolio totalled €3,600,000 utilised by 1,300,000 active borrowers.

In both parts of Europe more than a third of microlenders understand social exclusion as a lack of personal, economic and political opportunities. They define financial exclusion as not having access to credit. Microlending institutions are driven by the mission of alleviating exclusion by bringing financial services to the unemployed, financially excluded and particular at-risk groups. Microlenders in both sub-regions concentrate on providing access to credit for business purposes, rather than a range of financial products.

Microlending institutions focus their outreach on the groups identified by Eurostat data as at greatest risk of unemployment, social exclusion and poverty. Client data collected indicates that lenders successfully reach those excluded from mainstream banks. However, women and youth appear to be under-served in the West and East and rural areas seem under-served in the West. Data collection constraints make it difficult to assess immigrant and ethnic minority groups. The majority of microlenders do not actively help their clients to move towards mainstream financial services. However, indirectly, microlenders contribute to increased bank account usage as the majority of microlending transactions are processed via banks.

Recommendations

The working group makes tiered recommendations to the EU, Microfinance Institutions and Networks. These recommendations relate to disaggregated data collection, social and financial performance measurement, funding, efficiency and sustainability.

overview

Report 2:

Key constraints, challenges and policy recommendations

Background

A favourable microfinance environment is necessary to achieve economic development and social inclusion through self-employment. In the study 'Policy Measures to Promote the use of Microcredit as a Tool to Fight Social Exclusion', carried out by **FACET, EVERS & JUNG** and **nef** in 2004, specific recommendations were made to improve the policy environment for the microfinance sector. The working group decided not to re-write existing recommendations but rather to develop a clear tool that could be used by policy makers to measure policy changes over the long term.

Objective

To develop a tool, the eScorecard, to assess the extent to which the environment in each country is favourable for microcredit which will contribute to inclusive economic growth. The tool should be suitable for long-term use in order to promote mutual learning, exchange of experience and good practice among policy makers. This assessment and exchange process should ultimately influence and trigger policy change in the countries involved.

Outcome

The eScorecard is a multidimensional scorecard to identify, organise and rate comparable indicators for a supportive framework for microcredit in Europe. The working group developed a new eScorecard including changed dimensions/indicators (mainly referring to the content, framework). The Group designed procedures to regularly update information/process (including a questionnaire and an input interactivity model) and decided how to present the results and how to enforce the policy exchange process (output, interactivity, toolkit for policy exchange process).

Next steps and recommendations

Work is needed to develop an interactive website where various stakeholders (policy makers, experts, practitioners, etc.) will be able to enter data on the policy environment and where the outputs will be illustrations with underlying data and examples of good practice. Extra funding is needed to ensure the whole process will be fully operational, with national coordinators, an interactive database website and support for editing national and European reports on a yearly basis.

Recommendations cover the involvement of all stakeholders – who should be ready to share relevant information – in the process, the recognition that the use of a tool like the eScorecard can be powerful in increasing awareness of policy makers, and the necessity to contextualise benchmarking to evolve the sector. Microfinance networks should find ways to develop further the eScorecard by accessing new funds and by disseminating information related to this tool to all stakeholders, including policy makers, members and sector experts.

overview

Report 3:

Benchmarks and performance measurement

Background

Given the variation in political, economic and social conditions from one region to the next, the design and implementation of tools to measure performance and impact is not without difficulties. It is nevertheless vital to the health of the sector to possess the ability to evaluate its products, service delivery and impact. Practitioners across the sector must be able to understand and improve their own performance and to measure their progress against that of their peers, as well as to demonstrate to stakeholders the viability and value of MFIs within a social and economic context.

Objective

To develop a framework against which MFIs in Eastern and Western Europe can assess their performance and the impact of their activities both on an individual level and within the sector as a whole. The framework will be used as a tool to inform the amelioration of microfinancial products and services as well as improved efficiency, consistency and professionalism in the sector.

Outcome

The report has developed a framework based on a series of indicators that will enable both MFIs and stakeholders to improve their understanding of relative performance and that will provide good practice goals for the sector. This framework is an infrastructure that will enable practitioners to compile data, which in itself will inform the more effective setting of appropriate benchmarks and standards for groups of practitioners. MFIs will be able to use the framework to achieve greater professionalism, consistency and transparency in their activities, thereby increasing their credibility in the eyes of funders and other stakeholders.

Next steps and recommendations

Further work is needed to enable MFIs to both report against the framework and identify capacity building inputs to help improve performance where necessary. The next steps to be taken are the promotion of the framework amongst MFIs, their associations (networks) and stakeholders, the collation and segmentation of data, the establishment of indicators appropriate to individual regions and segments of the sector and the creation of a support process which will allow MFIs to respond to strengths and weaknesses highlighted by their assessment against the framework.

The working group makes tiered recommendations at EU, country, Network and MFI levels. These cover the development of capacity to understand and use the framework, the adoption of the framework as a key tool in the support and assessment of MFIs, contribution to the development of benchmarks by the provision of data, and the development of capacity to improve MFI's performances against benchmarks.

overview

Report 4:

Innovative approaches and products in combating financial exclusion

Background

Microfinance institutions should recognise that they serve a unique market and thus need to be innovative in reaching their target clients with appropriate products and services. MFIs operating in the EU work with people facing different kinds of disadvantage in a variety of economic, social and environmental contexts. Sharing this experience can serve as a starting point for the development of new products, services, approaches or cost-effective delivery mechanisms, both for MFIs grappling with those challenges, as well as policy makers who want to increase financial inclusion and generate economic development within their countries.

Objective

The working group identified examples of innovation in microfinance from Eastern Europe which could be applied in Western Europe and vice versa. All such innovations had to lead, directly or indirectly, to a reduction in financial and social exclusion. The working group also decided that it would only include case studies which were replicable in at least some other countries, and could show some evidence of success.

Outcome

The report presents 21 case studies which are grounded in the experience of MFIs across Europe and offer ideas for starting-points for new approaches. The case studies focus on at least one of three challenges facing MFIs and the microentrepreneurs they support. The first set of microfinance case studies offer ways to address the issue of reducing the costs of delivering microfinance, by using information and communications technology, particularly the internet, and by improving risk analysis. The second set addresses the need for more private finance which can be answered by increasing partnerships with banks, and offering loan guarantees. The third set focuses on the development of the microenterprise sector and on increasing sustainability of microenterprises by offering not only microcredit but also other financial and non-financial services such as leasing, microinsurance, and/or business support. One case study is separate and treats a different, but fundamental issue: financial literacy, the lack of which is one of the major constraints in the development of microenterprises.

Next steps and recommendations

The next steps to be taken are the promotion amongst MFIs, their associations (networks) and other stakeholders of the examples of innovation gathered in the report. The working group also recommends that the database of innovations be regularly updated. The report underlines key learning points and makes recommendations for policymakers and MFIs. These cover various issues, depending on the specific case study, but one of the key recommendations is that microfinance stakeholders should recognise that they serve a unique market and that innovation in marketing approaches, products, services and cost-effective delivery mechanisms is crucial to long-term sustainability.

networks involved in this project

The **Community Development Finance Association (cdfa)** is the UK's trade association for businesses providing financial services to those excluded from mainstream provision. Founded in 2002, it has over 90% of the UK's CDFIs in its membership. It provides a voice for its members at policy level, promotes the work of CDFIs and increases the capacity of the sector through a range of events and other services.

Bernie Morgan is the Chief Executive of the cdfa and steering group member for this project.

The **Microfinance Centre (MFC) for Central and Eastern Europe (CEE)** and the **New Independent States (NIS)** is a network of 103 microfinance institutions operating in 27 countries of the CEE/NIS and serving 800,000 low-income clients. MFC began operations in 1997. Since 1998, MFC's capacity building programme has provided over 300 training programmes and trained more than 2,200 microfinance specialists and policy makers. MFC's innovative Social Performance Management project aims to develop a unique and comprehensive process-oriented approach to social performance in microfinance, embedding it in strategic planning processes.

Grzegorz Galusek is the Executive Director of MFC and steering group member for this project.

The **European Microfinance Network (EMN)** was set up in 2003 to advocate microfinance as a tool to fight social and economic exclusion and to promote microentrepreneurship and self-employment. This is being achieved by supporting the development of microfinance organisations through the dissemination of good practices and by improving the regulatory frameworks for microfinance, self-employment and microenterprises at European Union and Member State levels. EMN has 54 members from 21 countries in Europe as of March 2007. Its main activities are the organisation of training, exchange visits, conferences, research, information sharing and lobbying activities for its members and any entities interested by the sector in Europe.

Philippe Guichandut is the Executive Director of EMN and steering group member for this project.

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Report 1:

Social and financial exclusion map

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Report 2:

Key constraints, challenges and policy recommendations

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Report 3:

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Report 4:

Innovative approaches and products in combating financial exclusion

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