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Quo vadis Microcredit in Portugal?

A case study of the day-to-day of an Entrepreneur

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Abstract— **A literature survey shows conflicts among the expected advantages of microcredit public-policies that might lead to discomfort on decision-making, and self-protection reactions due to increasing social demand for accountability. So, decision-makers lacking skills and sensitiveness to the entrepreneurial phenomenon, set assessment criteria, based on banking practice, inadequate to unemployed, young, low income entrepreneurs. Together with unorganized processes, this situation produces disrespectful loan proposals ignoring experts' opinions and business plans/contexts. The exploratory case of a Mutual Guarantee Society guaranteed by public funding: exemplifies ridiculous loan proposals for microcredit funding, conflicting with social grounds; shows entrepreneurs difficulties in accessing microcredit public-policies.**

Keywords-microcredit public policies; mutual guarantee society; social entrepreneurship funding; inappropriate loan officers; microcredit assessment criteria

I. Introduction

The alleviation of poverty has been a major concern of policy makers, both in developing countries and in the so-called rich nations. Improving the living standards of the most vulnerable segments of the population has become an ambitious goal in virtually all geographies. It was believed that entrepreneurship, supported by even small amounts of money, could make a significant difference for the poorer communities.

Although the rise of the crowdfunding platforms worldwide the academic research about the microcredit merits is still scarce. The presented case study provides some enlightening over one unsuccessful microcredit experience of an entrepreneur in Portugal through its description, analysis and discussion., . This typology of cases might establish a missing link between high level decision makers and the day to day reality of the public services aiming at operationalising the intervention programmes. Therefore, despite its exploratory scope, this case study shows a dark face of reality that might be fixed, in order to improve the overall microcredit public policies and so, put it back on track to pursue its original objectives.

The remaining sections of this paper are the Literature Review (II), The Case Study (III) and, finally, Discussion and Conclusions (IV).

II. Literature Review

A. Progress and Positioning of the Microcredit schema

Muhammad Yunus, winner of the 2006 Nobel Peace Prize led an experiment in Bangladesh that would get world recognition and countless attempts for replication in other regions. His Grameen Bank, founded in 1983, focused on providing very small (27 dollars) amounts to a large number of poor women, without requiring collateral. While many praised the achievements of microcredit in supporting small entrepreneurs, especially women, and liberating them from greedy moneylenders, others emphasized the high costs and default rates affecting many beneficiaries of micro credit, making them fall into a poverty trap. Bateman [1] found several cases were borrowers faced severe consequences for defaulting, namely in Cambodia were many people lost their homes for being unable to honor their mortgages.

While the debate among supporters and critics of microcredit has been heating up, the empirical study of its impact has been ambivalent. Nghiem et al. [2] conclude that micro finance fails to produce a significant impact. By contrast, Islam et al. [3] and Benerjee et al. [4] acknowledge some benefits for microfinance although with the caveat that the not so poor may benefit more than the most deprived segments of the population.

Micro credit competes with a broad range of formal, such as trade credit and regular bank loans, and informal types of credit. Besides the traditional and hard to measure role played by moneylenders, Rotating Savings and Credit Associations (ROSCAs) are playing a rising role in financing small new ventures. Tsai [5] provides an overview of these alternative tools.

When assessing the relative merits and impact of micro credit, one should expect that, where available, it would crowd out the position of moneylenders, as long as it proved to be cheaper and more efficient. Lack of this capacity [6] can be explained by the relative frailties of micro credit institutions, such as the possibility that formal lenders, protected from efficient competition, charge prices exceeding marginal costs, operate with excess capacity and spend too much on publicity rather than reduce the price of their product, creating an unintended social burden (p.104).

Banerjee et al. [4] provide a summary of the (seven) main results of a comprehensive set of studies, obtained with a randomized observation of six different countries, as follows: Bosnia and Herzegovina, Ethiopia, India, Mexico, Mongolia and Morocco (pp. 2-3):

- «What are the key takeaways, in our estimation? One is the existence of modest take-up rates of credit among (prospective) micro entrepreneurs, which is a *prima facie* case against microcredit being a panacea (a cure-all) in the literal sense and presents a statistical power challenge for randomized identification strategies. Second is the difficulty of meeting the power challenge by predicting microcredit take-up. … Third is the lack of evidence of transformative effects on the average borrower. Fourth is that the lack of transformative effects does not seem to be for lack of trying in the sense of investment in business growth. Fifth is that the lack of transformative effects should not obscure other more modest but potentially important effects. If microcredit's promise was increasing freedom of choice, it would be closer to delivering on it. Sixth, just as there is little support for microcredit's strongest claims, there is little support for microcredit's harshest critics, at least with respect to the average borrower. Seventh, the limited analysis of heterogeneous treatment effects in these studies does suggest hints of segmented transformative effects—good for some, bad for others.»

Modest and asymmetric transformative effects seem to be the main findings of very distant experiments with microcredit implementation. Rather than being a cure for all, microcredit experiences very different impacts. Customization, reflecting the specific environment of each region, on both the demand and supply side. As Arp et al. [6] suggest, microfinance organizations need fewer inappropriately incentivized loan officers and more entrepreneurial individuals.

B. Propositions

One might conclude from the literature review that the outcomes of microcredit are not yet clear. This lack of definition and confidence or, even, contradiction about the expected advantages of microcredit might lead, at least, to some discomfort on decision makers. In practical terms, this might also generate a self-protection reaction from both individuals and institutions, to face an increasing social demand for accountability of the decision makers. Therefore, the following propositions are put forward:

1) *Microcredit decision makers are neither sensitive, nor have the skills to understand to the entrepreneurial phenomenon, mindset and practice (P1)*

2) *Microcredit decision makers tend to set financial criteria that are too demanding, based on traditional banking practice (P2);*

3) *Microcredit Institutions set administrative processes that are too bureaucratic for entrepreneurs, which exhibit the typical weaknesses of complex procedural schemas (P3);*

4) *Microcredit institutions and individuals should be specialized on the topics of the business plans and rely on proved successful empirical practice to be prepared to properly appreciate the submitted business plans and assume their share of the risk (P4).*

III. Case Study

This case study describes an attempt to access a microcredit schema by an Entrepreneur and the related results. It starts by describing the funding schema. Then, introduces the business plan of the Entrepreneur. Two different results of the submission are analysed, i.e. rejection with no explanations and, acceptance with conditions. The strange fact is that the rejection decision of Mutual Guarantee Society (SGM) responsible for the final appreciation is much better for the Entrepreneur than the acceptance one.

A. Microcredit funding schema – ***Invest +***

1) Description

The described schema is advertised by several commercial banks that chose and accepted to support it. The provided information that follows is from one of the biggest Portuguese banks [7], despite it is the same that is advertised by other commercial banks.

This schema is supposed to be a social loan in special conditions that aims at supporting the SME creation. It is defined, as follows: «*Invest* + supports entrepreneurship and creation of SME that generate employment and foster local economy». Moreover, both recipients and access conditions are described. The supported investment ranges between 20,000 and 200,000€ and the maximum funding is 100,000€. The repayment plan occurs monthly during five years starting 2 years after the loan taking place and it was approved by the *Instituto de Emprego e Formação Profissional* (IEFP), the Portuguese Institute for Employment and Professional Training [8].

Moreover, and very important, *Invest* + is guaranteed in 75% by a Mutual Guarantee Society (*Sociedades de Garantia Mútua*, SGM). These are supposed to support SME funding, as well as foster their investment, development, restructuring by the provision of financial guarantees that facilitate obtaining credit. It is important to make clear that public funding is allocated to the National Insurance Fund, which covers the risk of the Mutual Guarantee Societies (SGM). In addition, the guarantees provided by the SGM are counter-guaranteed by the European Investment Fund [9].

In summary, this schema appears to satisfy the very first requirement of any type of business, which concerns the access to credit in acceptable conditions. Moreover, it provides a solution for the most important concern, when a loan takes place, which is the guarantees. This is a specifically sensitive point for an entrepreneur, in general, and for the *Invest* + beneficiaries that are in a very fragile social position. In fact, one might not expect entrepreneurs that are starting up new ventures and coming from a background made up by either (i) unemployed people, (ii) young people looking for the first job, (iii) people that never worked on its own, or (iv) independent workers with very low incomes [7] to provide sound and solid financial guarantees. However, the full schema of guarantees and counter-guarantees that is in place appears to be fully prepared to deal with this critical issue.

*2) Documents and process to access **Invest +***

There is no public institution available to provide a list of the documents that a candidate should put together or, better saying, the ones consulted provide incomplete and deficient information. The following list was obtained from a private association acting as a consultant on *Invest +*: (i) Personal ID; (ii) Curriculum Vitae; (iii) Certificates of no debts to Social Security and Customs & Excise (provided by public institutions); (iv) History of discounts to Social Security and history of unemployment support (provided by public institutions); (v) Activated Bank Account; (vi) Proforma Invoices of the investment; (vii) IRS statement of the last year (provided by public institutions); (viii) License for the activity (provided by public institutions); (ix) Renting contract or public property registration assuring the ownership of the place where the business operations would take place; (x) IEFP statement declaring that the candidate fulfills the conditions to access the *Invest +* schema; (xi) business plan; (xii) Bank of Portugal statement assuring the financial idoneity of the Entrepreneur. One might consider that this is a pretty complete and demanding process. In fact, a candidate that puts together all these documents is, undoubtedly, a serious candidate to take into consideration, from whoever is on the other side, receiving the whole process and assessing it.

To access *Invest +* a candidate needs to put all this paperwork together and to write up a business plan. There are some consulting organisations that are paid by government money to provide this service for free, despite being up to the entrepreneur to collect all the documents and supply all the required data for the business plan. These consultants, most of the times, do not provide any credible credentials and, trusting them is an act of pure faith. Actually, that is the best one might get for free. After the candidate's file having been compiled, it should be handed in one of the partner banks. The banks will analyse the business plan, elaborate a written appreciation and, then, pass it to the adequate Mutual Guarantee Society (SGM), which is one of the following: (i) NORGARANTE, in Oporto; (ii) LISGARANTE, in Lisbon; GARVAL, in *Santarém*, and (iv) AGROGARANTE for agriculture and forestry. Then, the entrepreneur will get the conditions for the loan after some non-determined waiting time.

*B. Development of a Business Plan in Agriculture to submit to **Invest +***

In the Autumn of 2013, the Entrepreneur sponsoring this study started a series of tests and a self-learning activity that lasted for 3 years, where he invested his savings. Meanwhile, different solutions for several plants and different seeds were tested in these home-made greenhouses.

Direct exposure to Sun light, use of plastic to cover up the soil were also tried in different seasons of the year. The entrepreneur concluded that the greenhouses are a relevant technology to assure success in modern agriculture. In addition, it was observed that local populations in the countryside showed up a strong preference to buy in local markets because of cultural motivations. So, the vegetables and the flowers markets of 5 or 6 villages within a 50 Km circle were closely scrutinized.

After these observations, the Entrepreneur decided to buy 1200m2 of professional used greenhouses, 3m high, half of them with a 25% zenith opening, in order to improve the conditions for carrying out further testing. These confirmed and expanded the previous preliminary conclusions. Thus, a business plan for deploying more 2,000m2 of new greenhouses, 5-6m high with a 25% zenith automatic opening controlled by a meteorological central was submitted to PDR2020 [10], the operational programme dedicated to the agriculture and rural development, in August 2016. Hydroponics and semi-hydroponics supported by automated watering were chosen as the main technology. Several supporting technologies were also included, such as a 5 kw solar panels station and two different positive cold refrigerators with humidity control, among other investment in infrastructures.

The PDR2020 project was fully appreciated both technically and financially by governmental experts that concluded about its merit. So, they decided to fully approve the investment and also, its related aid that was given in the form of non-repayable grants to recipients, in the total amount of 50% of the cost of the investment. It should be stressed that there were many projects approved but without any type of aid, which were placed in a waiting list for further comparison and later decision making, which was not the Entrepreneurs' case.

In conclusion, to implement the business plan there was a shortage of 100,000€, which grossly represented the remaining 50%. Thus, the Entrepreneur decided to apply for a microcredit loan to cover that amount. After analyzing the conditions of the *Invest +* schema, the Entrepreneur concluded that he fully satisfied the requirements for becoming a candidate.

C. Results Analysis

1) Pre-conditions to access the credit

One could still ask if the Entrepreneur was satisfying the access requirements of *Invest +*. Actually, this was confirmed by the certificates issued by the *Instituto de Emprego e Formação Profissional* (IEFP), i.e. «the IEFP statement declaring that the candidate fulfils the conditions to access the *Invest +* schema (issued on the 22nd September 2016)»; in fact, the IEFP was the main institution behind the implementation and deployment of theses microcredit schemas. So, there appears to be no margin for further questions on this topic.

Moreover, if the process was not 100% correct, the bank would have rejected it immediately. Thus, it would never reach the adequate Mutual Guarantee Society (SGM). However, in addition to the approval, the bank commented that this business plan was simply «the best one on its category that they had analysed» (*sic* Mr. J.C., December 2016).

2) Further extra requirements from the SGM

The Mutual Guarantee Society (SGM) performed its due investigating role by asking for the PDR2020 formal approval document also confirming the allocation of the non-repayable grants to recipients. This document was sent and, then, there was no possibility at all of discussing the merits of the project, because the experts from the Ministry of Agriculture had approved the aid based on both the technical and financial merit of the project.

The SGM decided to ask for demonstration of extra investment of the Entrepreneur on the project, which makes sense in order to show his level of commitment, specifically, of financial commitment. The *Invest +* candidate was providing evidence of an investment outside the PDR2020 business plan of around 45-50,000€, as follows:

- the implementation of around 1,200m2 of 3m high professional greenhouse that was not included in the PDR2020 business plan. However, this was going to contribute to improve the income of the project. On total around 15,000€ were invested by the Entrepreneur;
- building up 100m linear meters of wall with 2,5-3m high with a concrete structure to improve the security of the farm external boundary (more than 15,000€);
- Equipment: zenith opening, industrial jet-washing machine, farm sprayer, triphasic generator, irrigation systems, construction and automation of the special trolley to irrigate the nursery of the new greenhouse; administrative expenses, projects, licenses etc (around 10,000€)
- Land preparation to install the greenhouses and small wall construction (around 7,000€)

The evidence provided killed any legitim doubt of the SGM about the Entrepreneur financial commitment to the project.

3) Rejection with no explanation

On the 2nd January 2017, the Entrepreneur received an email from the bank forwarding an email from the SGM (dated 23rd December 2016) stating that the loan was not approved, with no further explanation or justification.

On the 3rd January 2017, the Entrepreneur asked the bank for the reasons for the loan having been rejected. No answer was provided but the bank sent an email to the SGM questioning them. The Entrepreneur reinforced this query, on the 9th January, directly to the SGM arguing that (i) all necessary documents were delivered; (ii) all the queries were answered; (iii) the business plan outstanding financial value was recognised by the bank; (iv) the business plan outstanding technical/financial value was recognised by the PDR2020; (v) there was an investment already done by the Entrepreneur of around 50,000€ in infrastructure and machinery. The SGM replied that they were going to analyse the situation.

4) Approval with conditions

In fact, the SGM found no arguments to reject the loan. However, the conditions attached to the loan offer were most demanding, as follows:

- The requested loan of 100,000€ was reduced to 40,000€ to be repaid in 60 monthly payments, starting 24 months after the loan granting. Moreover, the net financing would be much smaller than 40,000€ as a more detailed analysis will show;
- A guarantee for 30,000€ with a cost of 2.5% per year over the pending capital was required, yielding a total cost of around 3,500€;
- Freezing the fixed assets above 90% to avoid further loans. This means that from around 100,000€ the SGM wanted to freeze 90,000€, which is obviously exaggerated to cover the much lower approved loan;
- Obligation to buy a minimum of 600€ of SGM shares;
- Promissory note left in blank, to assure the full payment of the loan and related costs, guaranteed by four people;
- Using a bank deposit of 25,000€ from one of these four people, as the means to enforce a pledge.

It should be noted that these guarantees cover only 30,000 of the 40,000€ «loan». The Entrepreneur was neither informed of the conditions imposed by the commercial bank for the remaining 10,000€, nor of the exact interest rate because, at this point, further negotiation would be a waste of resources.

In summary, the Entrepreneur would get 15,000€ (40,000-25,000), from which around 4,000€ costs would still have to be deducted, reducing the net financing to about 11,000€, assuming that no interest or further costs would be charged. So, in order to obtain a net financing of 11,000€ the Entrepreneur would need to keep a 25,000€ bank deposit while bearing costs of approximately 4,000€. These conditions are inadequate for any Entrepreneur and particularly harsh for people facing financial difficulties, supported by the *Instituto de Emprego e Formação Profissional* (IEFP). It is important to notice that the risk of SGM guaranteed loans is further covered by the Portuguese State and the European Investment Fund. In fact, the terms offered were totally unacceptable by the Entrepreneur.

IV. Discussion and Conclusions

This paper describes the case of an Entrepreneur that submitted a business plan concerning the deployment of greenhouses for agriculture to a microcredit loan on the total amount of 100,000€. The business plan had previously been checked for its technical and financial value by the specialized experts of the Ministry of Agriculture (PDR2020) that approved it and allocated a grant covering 50% of the investment (around 100,000€). In addition, the partner bank of the microcredit schema did appreciate the business plan as «the best they had seen in that area». Therefore, no doubts existed about the value of the initiative. Nevertheless, the Mutual Guarantee Society (SGM) responsible for the final appreciation decided to loan only 40,000€ out of the 100,000€ that were asked, but only if «a few» conditions were met. After discounting the amounts required for the financial conditions and the costs of the loan the Entrepreneur would get around 11,000€, but he would need to have a frozen bank deposit of 25,000€, in addition to the other guarantees being asked, such as a Promissory Note left in blank and 90% of the fixed assets frozen to avoid further loans.

As regards *Proposition 1,* the most favourable conclusion that can be taken concerning the decision makers behind the microcredit schema, namely the SGM ones, is that they are completely lacking the skills and the sensitiveness to understand the entrepreneurial phenomenon, mindset and practice. At least, they need training and education; they should never be doing this job because they do not appear to be qualified to match its requirements and they miss a proper attitude.

As concerns *Proposition 2,* the case analysis suggests that the decision makers are setting criteria too demanding, based on traditional banking practice. According to the literature review microcredit procedures should be alternative and compete with the traditional credit mechanisms and, so, be different and adequate to the recipient status. This was not the case: the financial mechanisms and criteria were not only the same classic ones, but they were applied in the heaviest way possible to kill the entrepreneurship initiative. These criteria are completely inadequate to the entrance conditions of the public policy set to accept the recipients of this type of microcredit loan, i.e. (i) unemployed people, (ii) young people looking for the first job, (iii) people that never worked on its own, or (iv) independent workers with very low incomes. In addition, when required by the SGM, the Entrepreneur provided evidence of having already invested around 50,000€ in machinery and infrastructures, part of them 1,200m2 of greenhouses already in production, when the application for the loan for further expansion was done. This should had helped to overcome the lack of evidence of transformative effects on the average borrower that is cited in the literature review. Finally, after analyzing the final SGM proposal any independent observer would conclude that this proposal is neither serious, nor respectful for entrepreneurs and people in difficult social conditions alike.

Furthermore, Microcredit Institutions set administrative processes that are too bureaucratic for entrepreneurs and which exhibit the typical weaknesses of complex procedural schemas (*Proposition 3*). Not only there is a lack of availability of formal information about the required documents but information given at desks of the state institutions is incomplete and misleading. Sometimes they (both desk employees and service chiefs in local offices) even ignore (cannot explain or do not know) the programmes and schemas being advertised in the internal TV circuits just above their heads. Despite the support provided to entrepreneurs to elaborate the business plan and compile the file to be delivered is free, if they have the required statement from the IEFP, the service providers do not exhibit any credentials to enable the establishment of trust and confidence on their performance.

In fact, as regards *Proposition 4*, the existence of a Mutual Guarantee Society (SGM) oriented towards agriculture and forestry should had assured some kind of fairness and adequateness to the capital appraisal process on those areas. Unfortunately, if they existed, none of them did show up during the process. For instance, other public institutions with stronger credits in the area have assessed the business plan in a very different way (e.g. the PDR2020 evaluators). So, this evaluation mitigates the reported risk of default, in this case study, which is suggested in the literature review. Therefore, the remaining possibility is that the decisions makers were scared to assume their shared part of the risks and so, they decided to get rid of it in the easiest way, making the Entrepreneur to incur into a very unfair loss. In addition, to see denied his right to access a loan in supposed favourable conditions (as announced in the microcredit publicity), the Entrepreneur lost his time, money and hope in a trapped process that could never be successful. But even more serious is that this microcredit programme has been announced for years, and years and, it still goes on as a flag of the IEFP to fight poverty, despite only the fat agents employed by the State get advantage out of the schema without producing any useful outcome but only complicating the life of people that really want to do something positive, at least according to the reported experience.

To sum up, the authors tend to agree with Arp et al. [6] that microfinance organizations need fewer inappropriately incentivized loan officers and more entrepreneurial individuals. These officers are highly paid by the State to do a proper job, but, sometimes, they are not even qualified to do it. Thus, the result might very well be what happened in the reported case study. These experiences, both good and bad, are the evidence of the day-to-day practice felt by the Entrepreneurs, which must be shared, aiming at the improvement of the reported handicapped situations that go unchanged for years or, on the other hand, aiming at the spread of the good practices, if that had been the case.

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