Review of Microfinance Ireland 2015

An Roinn Post, Fiontar agus Nuálaíochta
Department of Jobs, Enterprise and Innovation

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Review of the Microenterprise Loan Fund

Executive Summary

Microfinance Ireland (MFI) began operating on 1 October 2012 providing loans of up to €25,000 to microenterprises that do not meet the conventional risk criteria applied by the banks. After 2 years of operations MFI had received 729 applications, supported 743 jobs in 333 microenterprises and approved loans valued at €5.137 million and delivered a 57% approval rate. This performance has been achieved through a period of significant economic uncertainty for many businesses across all sectors of the economy.

Section 22 of the Microenterprise Loan Fund Act 2012 (the Act) commits the Minister for Jobs, Enterprise and Innovation to commence a review of the performance of MFI within 2 years of the passing of the legislation. In conducting this review the Department considered (i) the market for microfinance, (ii) the operation of the primary legislation, (iii) the operation of the secondary legislation, and (iv) the performance of MFI over its first 2 years in operation. As well as an in-depth desk-based examination the Department undertook a broad-based consultation with key stakeholders.

The Act provides for the establishment of the Microenterprise Loan Fund and the management of this Fund by MFI. The review concludes that the Act remains fit for purpose, and no amendments to the primary legislation are required.

In examining the Scheme, the Department found that Paragraphs 3 and 6 pose some difficulties for the operation of MFI. Most particularly the bank refusal requirement and the prescriptive nature of many operational procedures were seen as likely impediments to the working of MFI. The review concludes that the Scheme should be amended to remove the requirement for microenterprises to be first refused credit by a bank. The review also concludes there is scope to improve the operational framework for MFI to ensure that the Board can adapt to the prevailing market.

In relation to performance, the activity levels of MFI to date do not match what was originally forecast. The expected pent up demand for microfinance did not materialise at start up as the difficult operating environment saw many businesses paying down legacy debts and not taking on new loans. Recent increases in the number of applications being received by MFI would appear to reflect a change in attitude by potential borrowers. The recent overall increase in the number of applications being approved does raise the possibility of increased defaults and the Department recommends that the MFI Board closely monitors the approval rates in order to ensure that the loans provided are fully consistent with MFI's overall risk appetite.

The low level of applications and approvals from some counties suggests that, in addition to ensuring that it reaches its target market, MFI needs to aim particular support at those counties. This will support Government policy to ensure there is appropriate regional support. There is also a clear need to focus MFI assistance at the segments Government is seeking, through its policies, to support such as: female, young, senior and immigrant entrepreneurs.

The Department is of the view that having no automatic bank referral of refused loan applications to MFI in place is possibly contributing to MFI not reaching its targets and not supporting microenterprises and jobs in the economy. MFI should continue its work with the banks and the Banking & Payments Federation Ireland to ensure an appropriate referral mechanism is put in place to capture MFI's target market.

The staffing levels in MFI were also examined during the review. The original staffing numbers were based on the anticipated figures and targets being reached from the first year of operation. These figures and targets have not been reached to date. However, MFI has informed the Department that the numbers of distressed loans are likely to increase as the loan book reaches maturity and that this will need to be properly managed. The Department and the Department of Public Expenditure and Reform will, in consultation with MFI, keep the staffing levels under regular review as overall activity levels and the number of distressed loans increase.

On balance, the overall conclusion of the review is that MFI has been moderately successful over its first 2 years of operation. It has provided over €5 million in loans to the economy, supported 333 microenterprises and 743 jobs which might have otherwise not been supported. While the expected pent up demand did not occur and the original targets set for MFI have not yet been achieved, MFI has been proactively engaging with sections of its target market and has developed its relationship with the LEO Network since its inception. This has proven to be important to the microenterprise sector.

The Department has made a number of conclusions and recommendations in this review which, if implemented, it believes will improve the take up and increase the awareness of the scheme and further enhance the availability of non-bank finance to microenterprises. Concrete actions will now be taken on foot of this review, including:

- A new Microenterprise Loan Fund Scheme,
- An automatic bank referral system for all bank declines of microenterprise loans, and
- A renewed communications and marketing strategy.

1. Introduction and Background

1.1 Establishment of a Microenterprise Loan Fund and a company to operate it

The majority of enterprises (90.7%) in the business economy are microenterprises and they employ over 26% of persons engaged in that economy.[1] The European Union defines a microenterprise as an enterprise which employs fewer than 10 persons and whose annual turnover and/or balance sheet does not exceed €2 million.[2] Access to finance for these microenterprises has been and remains an issue, with banks continuing to decline loans in the microfinance space (up to €25,000)[3].

Given the size and importance of microenterprises, and the difficulty they face accessing finance the Programme for Government 2011 and the Jobs Initiative of 2011 committed the Government to establish a Microenterprise Loan Fund and the necessary mechanism to issue loans from the Fund to microenterprises. Setting up a Loan Fund primarily focused at the locally traded sector was a new departure and a change in enterprise policy for the Department of Jobs, Enterprise and Innovation (the Department). The Department undertook the task of working with the various actors and stakeholders across the system to deliver this Fund for microenterprises.

It became apparent that a formal legal framework was required to establish the Microenterprise Loan Fund and resulted in the enactment of the Microenterprise Loan Fund Act 2012 (hereinafter 'the Act') in July 2012. The Act was commenced and MFI was incorporated in August 2012 as a subsidiary of Social Finance Foundation (SFF). SFF is the not for profit company which was established by Government in 2007 to be a wholesale lender of social finance and to assist in implementing the Government's social finance initiative. In establishing the microfinance wholesale facility, the Government agreed to build on the existing SFF model. MFI's memorandum and articles of association were approved by the Minister for Jobs Enterprise and Innovation with the consent of the Minister for Finance and the Minister for Public Expenditure and Reform in accordance with the provisions of the Act. MFI was granted charitable tax exempt status by the Revenue Commissioners. It received exemption from the Markets in Financial Instruments Directive and was not classified as a retail credit firm by the Central Bank of Ireland as required by the Scheme.

The Articles of Association of MFI provide that its number of Directors will be between 2 and 10. MFI currently has 9 non-executive Directors (including the Chair) who were all appointed by

[1] http://www.cso.ie/en/media/csoie/releasespublications/documents/multisectoral/2012/businessinireland2012.pdf Page 15 (Accessed 15th December 2014)

[2] Commission Recommendation (2003/361/EC) of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ No L124 of 20.5.2003, p36.

[3] In September 2011 44% of microenterprises were declined finance and by September 2014 this figure was 21%. While a vast improvement, microenterprises are still more likely to be declined than small enterprises (11% declines in September 2014) and medium enterprises (9% declines in September 2014). Source Department of Finance SME Credit Demand Survey April to September 2014.

SFF following consultations with the Minister for Jobs, Enterprise and Innovation and the Minister for Public Expenditure and Reform. This is in accordance with the Scheme and the Articles of Association. Ultimate responsibility for the performance and governance of MFI rests with the Board of Directors.

The Minister for Jobs, Enterprise and Innovation, with the consent of the Ministers for Finance and Public Expenditure and Reform made a Scheme (hereinafter 'the Scheme') in accordance with section 10 of the Act to give effect to the legislation, in September 2012. MFI was set up and incorporated by its parent SFF and opened for business on 1 October 2012.

Section 22 of the Act requires the Minister for Jobs, Enterprise and Innovation to commence a review of the operation of the Act within 2 years of its passing, and this review commenced in Q2 2014. In addition to a review of the operation of the Act, the review focused on the operation of the Scheme and the performance of MFI over 2 years of operation (to end September 2014).

1.2 Objectives of MFI

In Ireland, as in most developed countries, it is the banking industry that is, and always will be, the main source of funding for start-up and existing microenterprises. However, there are a proportion of loan applications which are declined by the banks that are inherently creditworthy and should be funded. The fundamental reasons for high levels of bank refusals in the Microenterprise sector are:

- lack of collateral held by microenterprises,
- traditionally high bad debt levels from the sector, and
- intensity of administrative overhead and time investment required in terms of loan assessment.

These reasons are often coupled with the relatively small size of lending proposition, with loan sizes averaging €16,000. These reasons often lead to missed opportunities in helping to create and support viable microenterprises and jobs.

In response to this, the Government established MFI and set out its main objective in paragraph 3 of the Scheme as:

"…to provide loans to newly established or growing micro enterprises across all industry sectors with commercially viable proposals that do not meet the conventional risk criteria applied by commercial banks."

The Scheme also states in Paragraph 3 that it:

"… is not intended to replace any current bank lending or to address any broad deficiencies in the banks' provision of lending. The banks constitute the first port of call/lender of first choice for loan applicants. Applicants will be required to confirm that they have been refused finance by a bank before their application to this Fund will be considered."

In order to meet this objective MFI provides loans of up to €25,000 to start-up, newly established, or growing microenterprises, which employ fewer than 10 people. The loans are to facilitate job creation and retention across the economy in all microenterprises with commercially viable proposals that do not meet the conventional risk criteria applied by banks for various reasons, including lack of collateral or lack of a credit history. Therefore, MFI is designed to fill a gap in the market.

On a practical level, to achieve this objective, MFI performs loan application assessment, loan approval and decline, management of a microenterprise loan book, and recovery of loans. MFI also works with key stakeholders including Banks, Local Enterprise Offices (LEOs), the European Investment Fund (EIF) and enterprise agencies in delivering its services.

1.3 MFI Funding Model

The MFI funding model was designed to seek an initial non-refundable €10 million seed fund from the State through the Minister for Jobs, Enterprise and Innovation, which would be leveraged with €15 million from the banks in tranches of €5 million over the following years. These moneys were to be recycled to generate €40 million in loans and create 3,800 jobs over a 5 year period. The model was constructed based upon assumptions of an annual €8.8 million of loan demand and 20% bad debts per annum. The €10 million grant was made by the Minister for Jobs, Enterprise and Innovation to MFI in 2012, pursuant to Section 5 of the Act.

Provision was made in the model for the possibility of a further injection of €10 million by the State in year 5, supplemented by an additional €15 million bank borrowing in tranches of €5 million, if deemed necessary. If the initial loans were successful the total funding was estimated to have the potential to generate a total of over €90 million in loans, financing 5,500 micro-enterprises and generating over 7,700 jobs over a 10 year period. Overall, the Act caps the maximum state grant at €25 million in total.

1.4 Lending Policy

The Scheme sets out the objective of the Lending Policy which is to lend monies to create the optimum number of jobs in the microenterprise sector, commensurate with the agreed credit risk levels. The Lending Policy is under the control and governance of the Board of Directors of MFI. MFI has a Credit Committee which can recommend changes to the Lending Policy in light of the quality of loans approved and associated loan loss provisions and write offs.

The thrust of MFI's lending policy focusses strongly on the potential sustainability of a business, its ability to repay a loan and the creation and maintenance of jobs. The policy provides that all decisions regarding loans should be consistent with MFI's risk appetite, which is higher than a banks, and based on the quality of the applicant and his/her business. Decisions should not be driven by a desire or behaviours to achieve a target for the number or value of loans approved and drawn, at the expense of credit quality.

1.5 Review Methodology

The method adopted in concluding this review was a broad-based consultation process with the various stakeholders, combined with a thorough desk based examination of each of the following:

- The operation of the Microenterprise Loan Fund Act 2012 (as required by section 22 of the Act),
- The operation of the Microenterprise Loan Fund Scheme 2012 (SI No 343 of 2012), and
- The performance of MFI over 2 years.

1.5.1 Stakeholder Consultations

A crucial element of the review was consultation with key stakeholders. Officials at the Department of Jobs, Enterprise and Innovation engaged in discussions with these key stakeholders from August 2014 to November 2014 and afforded them the opportunity to submit written submissions.

The following parties were consulted:

- Microfinance Ireland,
- Social Finance Foundation,
- AIB,
- Bank of Ireland,
- Ulster Bank,
- Irish League of Credit Unions,
- Banking and Payments Federation of Ireland,
- ISME,
- SFA,
- Chambers Ireland, and
- LEOs.

The review was also discussed at the SME State Bodies Group.

A number of issues and concerns were highlighted by the stakeholders. In summary these included:

- The requirement to be refused credit by a bank is impeding applications,
- The Scheme is considered by many to be too prescriptive,
- An automatic referral system to MFI of refused bank applicants is required to ensure optimal engagement with the financial system,
- The MFI Loan size is considered by some to be too small,
- Promotion and advertising needs to be more effective and generate greater brand and topic recognition, and
- Staffing requirements will change as the number of applications, loans and default rates change.

1.5.2 Desk-based review

The consultation process was accompanied by a desk-based review of performance to date against initial assumptions and demand for the product along with a consideration of the appropriateness of the supporting legislation (the Act and the Statutory Instrument) to achieve the goals set out at the launch.

The results of the stakeholder consultation and the desk based review is set out in chapters 3 and 4 of this review. These results are preceded by a chapter setting out the estimated size of the market for microfinance in Ireland.

The final chapter sets out a summary of the main actions to be taken as a result of this review process.

2. The size of the Market for Microfinance in Ireland

The business case and model for the establishment of MFI brought to Government in November 2011 envisaged 1,100 microfinance applications per annum being received and 550 loan approvals per annum being supported over the first five year period. If successful, provision was made for a further injection of funds by the Government for a second period of five years and, where such further provision would leverage additional private sector support, which could result in a total of €90 million in loan expenditure, financing 5,500 loans and supporting 7,700 jobs in the economy. The business case was based on the perception that there was considerable pent up latent demand in the Irish economy at the height of the economic crisis and that the then City and County Enterprise Board network (now LEO network) would operate as an effective distribution channel, through which advice and loans would be channelled. Unfortunately, this pent up demand did not materialise in the first instance as many SMEs repaid existing loans rather than take on new credit.

In the light of weak initial demand, Mazars (a professional services firm providing services such as audit and assurance, consultancy, corporate finance and taxation services)was commissioned by MFI to undertake a review of the size of the Irish microfinance market. The Terms of Reference of the Mazars study were designed to provide the Board of MFI with a better understanding of:

- The overall size of the market for credit amongst microenterprises,
- The SME environment (with specific focus on microenterprises),
- The patterns and trends associated with finance requirements for microenterprises,
- The subsequent behaviour of microenterprises that were rejected finance, and
- SME awareness of the Irish funding landscape.

In addition, the report addressed the key issue for MFI, which is to understand the size of the market and level of potential demand for the provision of credit by MFI to microenterprises in Ireland.

The Report, completed in March 2014, suggested the market of microenterprises declined bank credit and seeking a remedy elsewhere was approximately 4,800 firms based on 2011 figures. The Report confirmed that there was a significant requirement for microfinance and suggested that the original estimate of 550 loan approvals per annum remained a realistic goal for MFI. The Report concluded that the original objective of supporting 7,700 jobs and the delivery of €90 million in funding over 10 years remained valid subject to the implementation of a number of recommendations relating to how the Scheme and MFI itself operates.

Having considered the Mazars report and recent market developments the Department is convinced by its analysis in terms of the size of the market and also agrees that the overall ambition of supporting 7,700 jobs and lending €90 million over 10 years is feasible.

It is recognised that on foot of the performance to date MFI is not 'on target' to deliver on the original medium term ambition of €40 million in loans and creating 3,800 jobs over a 5 year period. However, the Department is of the view that the economic climate combined with a renewed Scheme and the hard work of MFI will see the longer-term goal met.

Summary of main Conclusion:

- On the basis of the size of the market for microfinance in Ireland, and with positive economic conditions the Department is of the view that the original ambition for MFI of supporting 7,700 jobs and lending €90 million over 10 years is feasible.

3. Review of the Operation of the Microenterprise Loan Fund Act 2012 and the operation of the Microenterprise Loan Fund Scheme 2012

3.1 Review of the operation of the Microenterprise Loan Fund Act 2012

Section 22 of the Act requires the Minister for Jobs, Enterprise and Innovation to commence a review of the operation of this Act not later than 2 years after the date of its passing. The Act was passed in July 2012, and the review commenced in June 2014.

In broad terms the Microenterprise Loan Fund Act 2012 provides for the establishment of a Microenterprise Loan Fund and for the formation of a company to manage that Fund. The Act empowers the Minister to provide a grant of €10 million to the Fund from monies voted by the Oireachtas, which was done in 2012, with potential for the provision of further funding of up to €15 million. The Act also gave authority to SFF, as the parent entity of MFI, and with the consent of relevant Ministers, to borrow money for the purposes of MFI lending subject to a limit of €25 million.

Section 10 of the 2012 Act gives the Minister for Jobs, Enterprise and Innovation, with the consent of the Ministers for Finance and Public Expenditure and Reform, authority to make a scheme or schemes for the purposes of giving effect to the Act which may make provision for matters such as the maximum size of loans, the purpose of the loans, and the terms of agreements of the loans.

The Department has examined each of the individual provisions of the Act in the course of this review and has not found any issues that need to be addressed through a revision of the primary legislation. The fundamental legislative basis for the Fund and the establishment of MFI to disburse the Fund remains, in the view of the Department, fit for purpose. This view was endorsed by the stakeholders consulted during the review who raised no issues with the provisions of the primary legislation.

3.2 Review of the operation of the Microenterprise Loan Fund Scheme 2012 – Statutory Instrument No. 343 of 2012

Paragraph 15 of the Scheme requires that the Scheme itself be reviewed annually by the Department and SFF to ensure optimal functioning. The Department, SFF and MFI have an ongoing liaison relationship through which the operation of the Scheme has been kept under review.

This larger structured review process (as described in chapter 1) is taking place after MFI has been operating for 2 years, and offers the Department, in consultation with SFF, MFI and various other stakeholders, the opportunity to determine what, if any, changes need to be made to the Scheme.

As indicated above, section 10 of the Act provides the framework for the making of a Scheme. Under this framework the Scheme may make provision in relation to all or any of the following matters:

- The class or classes of microenterprise to which the Scheme applies,
- The purposes for which moneys loaned by MFI may be applied,
- The maximum loan size,
- The terms of agreement of the loans,
- The preparation and maintenance by the microenterprises of records, books of account and such other documentation,
- The giving of documents, information and reports by MFI to the Minister,
- The policies and practices of MFI as respects:
    - Lending,
    - Recoveries, and
    - Provision of security.

The Scheme provides detailed information on:

- the objective of the scheme,
- the appointment of SFF as administrator,
- the lending policy,
- lending procedures,
- the role of the City and County Enterprise Boards (now the LEOs)
- operation of the Fund,
- Ministerial and Departmental oversight,
- the Chairman and Board of Directors,
- Internal Governance,
- Management Information Reporting,
- Audits,
- Staffing and Human Resources,

- Review, and
- Termination.

The Scheme came into operation on 4 September 2012 and MFI opened for business on 1 October 2012. The Scheme itself was drafted before MFI and the MFI Board were established and operational, and therefore, it was quite operationally focussed. This was to allow MFI and its Board to hit the ground running and to avoid it having to wait for the development of a range of policies and procedures before it opened for business. At this point in time the Board of MFI is well established and MFI itself is operating for over 2 years. Accordingly, it is timely to consider how the Scheme can be improved and the areas where Board oversight is most appropriate.

Following a thorough examination of the content of the Scheme by the Department, and various consultations with stakeholders, the dominant issues that arose in relation to its effectiveness and that required decisions as to whether changes to the Scheme should be made related to the requirement for a bank refusal (paragraph 3 of the Scheme), and operational lending procedures (paragraph 6 of the Scheme).

The Department has, therefore, determined that no other paragraphs of the Scheme require any substantive changes. A number of paragraphs could benefit from a general update. For example paragraph 4 describes how SFF shall manage and control the Fund on behalf of the Minister through the establishment of a dedicated subsidiary MFI. As MFI is now established the Scheme might benefit from an introductory or recitals piece (a preamble) that sets out some of the basics on SFF, MFI and the legislation. This would then see amendments to paragraph 8 to take out the requirement for MFI to seek charitable status, exemption from the Markets in Financial Instruments Directive and to ensure MFI will not be classified as a retail credit firm. Therefore, the Department will, in drafting any 2015 Scheme for the Minister ensure that, as appropriate, historic pieces, or those dealt with in the primary legislation would feature in a short preamble to any amendment to the Statutory Instrument.

In addition, the Department is of the view that there is potential for deeper engagement between the LEOs and MFI. In this regard, if the Scheme would benefit from changes to strengthen this relationship then the Department will ensure that any new 2015 Scheme is appropriately amended.

Any new Scheme made under the Act will require the consent of the Ministers for Finance and Public Expenditure and Reform, and consultation with SFF. Therefore, conclusions reached in this review in relation to any Scheme changes will be subject to further consideration by these parties when a draft Scheme is produced by the Department. Final text for a revised Scheme is not being provided as part of this review.

The remainder of this part of the review will focus on the dominant issues of bank refusal requirement and operational lending procedures.

3.2.1 Paragraph 3 of the Scheme

Paragraph 3 of Scheme sets out the objective of the Scheme, which is to provide loans to newly established or growing microenterprises across all industry sectors with commercially viable proposals that do not meet the conventional risk criteria applied by commercial banks. As the Scheme is not intended to replace any current bank lending or to address any broad deficiencies in the banks' provision of lending, and as the banks constitute the first port of call/lender of first choice for loan applicants, the Scheme includes the proviso that applicants are required to confirm that they have been refused credit by a bank before their application will be considered. This was to ensure that MFI was not competing with the banks and that it provided additional lending that would not otherwise be provided within the normal commercial market.

This 'refusal requirement' was inserted into the Scheme to prove that the lending envisaged was additional to normal bank lending. This requirement was in support of the objective of the Scheme and was designed to reflect the existence of real market failure.

The issue of the need for a bank refusal prior to applying to MFI for funds emerged as an issue for microenterprises applying to MFI since its inception. As a first step and in order to overcome initial concerns a system of self-declaration of a refusal was introduced during its first year of operation in 2013. This was designed to assist applicants who were reluctant to obtain a formal refusal from the banks as they incorrectly feared that this could reflect badly on their personal credit ratings. Therefore, a more informal discussion between the microenterprise and its bank could result in the microenterprise being able to self-certify a bank refusal.

During the consultations held on the review the prevalent view of stakeholders was that a refusal requirement did discourage an element of the microenterprise sector from applying for an MFI loan. Stakeholders felt that once a decline from the bank has been received, microenterprises are then reluctant to go on and apply for a loan to MFI and risk a second refusal/rejection.

On balance the Department is of the view that the purpose or main objective of the Microenterprise Loan Fund is to target assistance for microenterprises and start-ups that are not typically bankable. The Fund should provide this required "gap" financing, meaning that funds are only provided when no other financing sources are available. Therefore, the Fund is not seeking to compete with traditional banks and, indeed, should not compete with traditional banks where to do so would not be in the best interest of the microenterprise, for example in terms of the cost of a loan. While a formal or informal bank decline is certainly definitive evidence that a microenterprise is not bankable, the fact that a microenterprise has not approached a bank for a loan does not necessarily mean it is a bankable microenterprise.

The Department is cognisant that the removal of the refusal requirement may have some impact on the banks' microenterprise loans (up to €25,000) market. If applications are made directly to MFI without going through a bank refusal it could see MFI competing with the banks in this market. However, the interest rates on offer from MFI will continue to exceed those on offer from the banks, reflecting the risk profile of the MFI loan book. In any event, MFI will continue to actively pursue the 'non bankable propositions' in the market for which MFI is established to target. At local level this can be done through the LEO Network. Potential MFI clients will be referred by the LEO to MFI, where the LEO is of the view that the microenterprise is a suitable applicant and not capable of getting bank credit and such an applicant will benefit from a lower interest rate than the standard MFI interest rates. In addition, as part of the Credit Policy it might be appropriate to provide that where a credit assessor forms the view that a microenterprise is a bankable proposition that this would be brought to the microenterprises attention. Ultimately it will be a decision for the business person and there may be times when the higher rate offered by MFI may appeal, although such microenterprises should be encouraged to seek bank funding.

Having given full consideration to the views of the relevant stakeholders and examined the refusals related material the Department considers that the refusal requirement is, indeed, impeding applications for this specialised segment of micro lending, and should be removed in order to allow microenterprises to apply directly to MFI. This does not alter the main objective of the Scheme, and a new paragraph 3 objective section should be drafted, which will remove the requirement for the microenterprise to have been refused by a bank before it can apply for a loan from MFI.

3.2.2 Paragraph 6 of the Scheme

Paragraph 6 of the Scheme sets out the lending procedures to apply to MFI loans and details the following items:

- (i) Loan Eligibility,
- (ii) Purpose of Loan,
- (iii) Permissible Loan Values,
- (iv) Calculation of Interest Rate,
- (v) Fees,
- (vi) Repayment Frequency,
- (vii) Loan Application Process,
- (viii) Credit Assessment and Security Procedures, and
- (ix) Recoveries Procedures.

(i) Loan Eligibility

The purpose of the inclusion of some eligibility criteria within the Scheme is to provide the framework for MFI loans. The following elements of the eligibility criteria are necessary: that the business be based in Ireland, that the applicant must have a Personal Public Service Number and Tax Clearance Certificate. In addition, the business must have a business plan, this is a necessary piece for loan assessment. Finally, as discussed above the Department has concluded at 3.2.1 above that the requirement for a bank refusal is indeed impeding microenterprises from applying to MFI. Therefore, on balance paragraph 6.1.1 should be revised to remove from the eligibility criteria the need for a bank loan refusal on the basis of the determination above.

(ii) Purpose of Loan

The purpose for which the loan can be granted is outlined in the Scheme which is to provide loans in the space of business start-up costs, expansion costs and working capital. This is broadly stated and the Department is satisfied it covers the business cycle financing requirements of a microenterprise. Therefore, the Department is not proposing any changes to paragraph 6.1.2.

(iii) Permissible Loan Values

The Scheme provides that the maximum loan value is €25,000. This maximum loan size is based on limits used by the European Commission European Progress Microfinance Facility (Progress Microfinance) and the EIF's willingness to provide guarantees up to €25,000. During the development of the Scheme the Department and SFF considered that this maximum level of loan would best meet the needs of the microenterprise sector.

MFI now considers that the maximum loan size should be increased. This would enable MFI to improve its offering and allow the body to complement its current risky loan portfolios with less risky higher value loans to slightly larger concerns. At present performance statistics show that the MFI offering is being taken up by microenterprises with 3 or less employees. MFI has indicated that it has a greater credit risk appetite and that higher value loans would mitigate the danger of some of its lower value current stock of loans.

During the course of the Department's consultations on the review some of the SME lending banks expressed concern with increasing the loan size limit. They considered this would place MFI in direct competition with them contrary to the initial rationale behind the introduction of MFI, i.e. to complement and provide additional lending in the microenterprise sector. In addition, some of the banks questioned the logic of their support for this initiative if MFI was placed in direct competition with them for small loans up to €50,000. The Department is of the view that MFI was not established to compete with the banks and that this should continue to be the case.

The Department is also cognisant of the fact that the European Commission defines microloans as loans under €25,000 and according to a recent 2014 report provided to the European

Parliament on the performance of the European Microfinance Programme there is little or no appetite across the EU to go above this loan limit at this time.[4] It would seem appropriate that Ireland would support microloans in line with any EU definition, and in addition it is useful to see the EU research indicating that there was no real appetite for loans above this level.

The Department has also considered whether there is a target market of non-bankable larger microenterprises employing 4 or more employees who are seeking higher levels of loans. As indicated at the start of the review according to CSO data microenterprises account for 90.7% of all active enterprises. This equates to 168,281 active enterprises, with 323,502 persons engaged (where a person engaged includes employees, proprietors and family members). This means that on average there are just under 2 people actively engaged in each microenterprise in Ireland. Therefore, it is likely that MFI is indeed servicing the full microenterprise market and that perhaps there is not a large cohort of these "larger" microenterprises.

Finally, the Department also in gathering data for the review noted that the current average size loan given by MFI stands at €15,400. It also noted that co-funding is permissible, i.e. a loan from MFI can be made available to 'top up' bank credit where it is clear that the business will not succeed without it. Therefore, a microenterprise may apply for €25,000 from MFI in tandem with applying for a bank loan.

In light of the foregoing, the Department does not consider that the case has been made for an increase in the loan level and considers that Paragraph 6.1.3 of the Scheme should not be changed. This does not preclude any future considerations on loan size that could result in a different maximum loan value.

(iv) Calculation of Interest Rate

Under the Scheme the calculation of the interest rate charged must be set by the MFI Board as set out in Paragraph 6.1.6 and must be set on the basis of the cost of the funds borrowed from SFF and a margin of up to 5% which contributes towards the administrative and overhead costs of MFI. The current rate applicable to loans set by the MFI Board is 8.8% (APR). However, MFI has recently applied a lower interest rate of 7.8% (APR) to successful loans which originate from the LEOs due to the perceived better quality of those applications. MFI's credit policy also allows for some flexibility in terms of moratoriums and rescheduling of loans.

The review examined the issue of the interest rates charged by MFI for its loans. During the consultations no stakeholders raised this as a major concern indicating that once the cost of the funds was kept to a minimum an administrative charge of the type envisaged in the Scheme was appropriate given the high risk profile of the loans. The Department shares this view and

[4] ec.europa.eu/social/BlobServlet?docId=12682&langId=en (Page 10) Accessed 31st October 2014

accordingly proposes that the provisions of Paragraph 6.1.4 should remain the basis for the Board's calculation of interest rates for MFI products.

(v) – (ix) Fees, Repayment Frequency, Loan Application Process, Credit Assessment and Security Procedures, and Recoveries Procedures

During the course of this review MFI made a submission which indicated its view was that the Scheme should be at a more strategic level and should be principles rather than rules base. This would allow the Board of MFI the ability to take action within this remit without the need to apply to the Minister to change the rules each time a new market failure was identified.

Having reviewed the balance of Paragraph 6 of the Scheme in full the Department considers that issues such as Fees, Repayment Frequency, Loan Application Process, Credit Assessment and Security Procedures, and Recoveries Procedures are matters properly within the remit of the board of MFI to reach decisions upon and would more appropriately sit in a board decision document than in prescriptive secondary legislation (the Scheme). The Department believes that removing these paragraphs from the Scheme will facilitate the work of the Board and will ensure that MFI will be able to respond quickly to any changes in the microfinance loan market.

The review is seeking to provide the platform to allow the Department to produce on behalf of the Minister a draft Scheme that will require consent of the Ministers for Finance and Public Expenditure and Reform, and consultation with SFF. This Scheme will be developed based on the learning from the operation of MFI and this review, and will seek to provide the Board with the appropriate level of flexibility to undertake its work, and to allow MFI to operate in an efficient manner within a suitable framework.

In order to facilitate flexibility and adaptability the Scheme could state that the Board will make an appropriate document (most likely the Lending/Credit Policy) setting out the framework, which will be approved by the relevant Ministers. Ultimately, the Scheme and any Board decisions or documents must be made in accordance with the Act and this provides the ultimate framework under which the Board and MFI operate.

Summary of main Conclusions and Recommendations:

- The Microenterprise Loan Fund Act 2012 remains fit for purpose and does not require amendment.
- The requirement for a bank credit refusal before seeking MFI loans should be removed from the Scheme, facilitating direct access to MFI for microenterprises.
- The Scheme should be amended to facilitate flexibility and adaptability by the Board of MFI to market changes.

4. MFI Activity and Performance to Date

4.1 Introduction

At the launch of MFI in 2012 it was envisaged that the Scheme would support 5,500 businesses and 7,700 jobs and lend €90 million over a ten year period. The 5 year targets were €40 million in lending to 2,700 businesses supporting 3,800 jobs.

The original assumptions and targets for MFI were based on annual projections of activity consisting of:

- 1,100 microenterprises seeking loans from MFI per annum,
- Approximately 50% MFI loan approval rate – leading to 550 microenterprises granted loans per annum,
- Average loan €16,000 – with between €8million and €9million of loans being granted per annum, and
- 20% bad debts.

The original business case for MFI envisaged no lead in period due to the perception that there was considerable pent up demand in the economy and also because the then County and City Enterprise Board network would provide a powerful established distribution channel. However, in spite of some strong national, local and regional promotion, Ministerial speeches and a communications strategy driven by the Board the level of annual demand and activity levels did not materialise as expected.

4.2 Brief overview of performance after 2 years operation

Since it opened for business on 1 October 2012 to 30 September 2014 MFI:

- received 729 applications,
- approved loans valued at €5.137 million, and
- supported 743 net jobs in 333 micro-enterprises.

Of the 729 applications 580 have been fully processed. 333 applications (57% of 580) were approved, 247 declined, 44 work in progress and 105 others that were not progressed for various reasons.

The initially expected demand detailed in the business case for MFI did not materialise due to a number of factors including: market realities of companies paying off rather than taking on credit, administrative and governance requirements needed to be put in place in MFI, and there have been some staffing issues.

This resulted in MFI getting off to a slower than expected start. In hindsight this could have been factored in and the model could have taken into account the need to build brand and presence within the market. This establishment piece would be expected in any newly established organisation. It takes time to establish and promote new organisations and for them to resonate in people's consciousness. However, MFI has been gaining traction in the market over the last 2 years and increasing its levels of activity.

In the last year there has been a pick-up in the rate of application and approval of MFI loans. This reflects an upturn in economic activity generally and in the awareness of MFI as a player in the microfinance space. This pick up is expected to continue as growth accelerates. In the light of this and the enhanced awareness of MFI in its target market, the Department considers that the original loan targets remain achievable even if it takes slightly longer than originally envisaged.

4.3 How does this performance break down?

This section of the review will examine a number of aspects of performance, in particular, it will focus on performance by segments, the monthly pipeline, approval rates, performance by loan size, performance by enterprise size, and performance by geographical spread. This analysis of performance and then of the revised targets, will influence the remainder of this chapter which will look at the issues of staffing, promotion and bank referrals.

4.3.1 Performance by segments (start-ups, youth entrepreneurs, females, seniors and migrants)

58% (194) of approvals were granted to start-ups in business for less than 18 months, while the remaining 42% (139) of approvals were granted to existing enterprises. MFI approvals are heavily skewed towards start-ups. This is in line with Government policy which is to assist those who are unable to access bank credit and this is a barrier for start-ups due to the lack of a track record.

76% (556) of applications were from male promoters and just 24% (173) from female promoters. Of the loans approved as at 30th September 2014, 74% (246) were to male promoters while 26% (87) were to female promoters. The 2011 census data shows that approximately half the population are women. However, there is no data available on the number of women business promoters. As a possible proxy, Labour Force participation rates in 2011 for men were over 68%, and for women were over 53%. In addition, the Global

Entrepreneurship Monitor 2013 for Ireland in relation to early stage entrepreneurs indicated the ratio of men to women was 1.9:1. Therefore, it is probable that women are less likely than men to be business promoters. So while the male female split may be representative there is scope for improvement and from a policy perspective this would be welcomed. Male approval rates were 44% while female promoters had a 50% approval rate. This shows a higher loan application approval rate among female entrepreneurs which is in line with Government policy.

10 (3%) loans were approved to young entrepreneurs. While 66% of 20-24 year olds participate in the Labour Force, it would be expected that there would be a much lower number of people starting or running a business up to the age of 26. Therefore, it is likely that this is relatively representative of this cohort. However, this does mean there is a greater scope to target young entrepreneurs and that would be in line with Government policy. The Entrepreneurship Policy Statement published by DJEI in 2014 recognises the potential of the youth cohort to grow business and the Department considers it critically important that MFI contribute to realising the great potential of Ireland's young entrepreneurs. It would therefore be appropriate for MFI to establish a specific Youth Fund, which would ring-fence a portion of the Microenterprise Loan Fund for this cohort who face specific barriers to accessing bank credit.

In addition, early stage entrepreneurship can be higher among immigrants than the non-immigrant population. Senior entrepreneurs have experience and knowledge, which can be harnessed to the benefit of the economy. The Department considers that MFI should be conscious of the opportunities that exist in these entrepreneurial segments and specifically target immigrant and senior entrepreneurs in addition to female and youth entrepreneurs.

Ultimately, the Lending or Credit Policy to be made and kept under review by the Board, as envisaged by paragraph 5 of the Scheme, will always be focused strongly on the potential sustainability of the business and the creation and maintenance of jobs, commensurate with agreed credit risk levels. Therefore, any special promotion or targeting will be in accordance with the Lending or Credit Policy.

In relation to promotion and targeting female, youth, senior and migrant entrepreneurs, the Department would recommend that a specific focus be brought to MFI's Communication's Strategy. The low level of applications from female and youth entrepreneurs raises concerns about the effectiveness on MFI's efforts to engage with these groups and points to the need for MFI to review its level of promotional engagement to date with these under-represented groups. There is also scope to enhance promotion activity in respect of migrant and senior entrepreneurs. As part of a new Communications Strategy the Department considers that the Board should examine the potential to utilise some innovative channels such as:

- The Irish League of Credit Unions (where many people involved in business, in particular sole traders may be seeking financial assistance for business ventures),

- Solas (the State's Further Education and Training Authority, which provides a number of courses aimed at individuals starting their own business),
- Citizens Information Board and Centres (where people seek advice on supports available to them), and
- The G.A.A. (a potential source of engagement given its reach across the country, particularly in relation to young people).

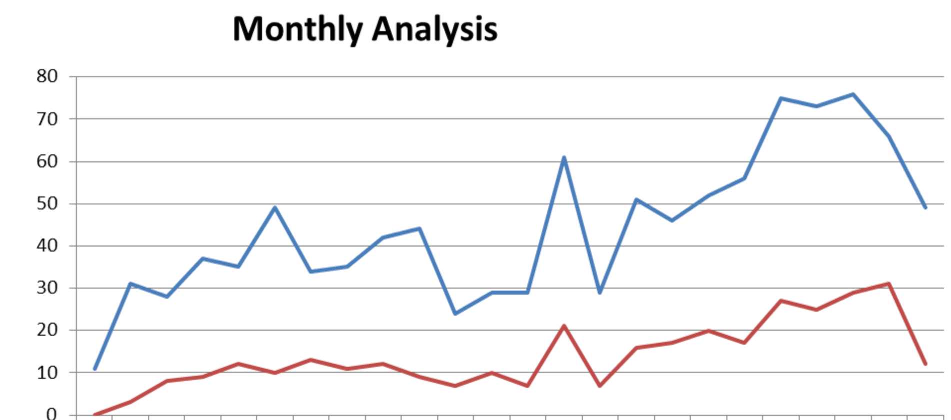
These channels could also be used more generally by MFI to raise awareness and thus increase applications. MFI could also establish whether these organisations are in a position to support both general awareness raising and or more segment targeted promotions. Promotion and Awareness will be discussed further later in this chapter.

4.3.2 Monthly Application Rates – the pipeline for approvals

MFI is currently receiving an average of 40 applications per month compared to an originally envisaged 92 applications per month. The number of applications per month is growing, and this is to be welcomed, but not at a rate which is adequate to make major inroads in this sector. More recent performance would appear to suggest an upturn in applications both directly and through the LEO channels. While data used throughout this review refers to the first 2 years of operation to end September 2014 it can be reported that in December 2014 62 applications were received and in January 2015 63 applications were received. This is promising in terms of increasing the pipeline for approvals.

MFI received a total of 729 applications (See Table 1) from 1 October 2012 until 30 September 2014. This amounts to an average of 7 applications being received per week. 5.5 applications were processed per week and 3 loans were approved each week over the same period. To reach 550 approvals per annum, MFI needs to approve 11 loans per week (over a 50 week year). This means MFI would need to be receiving over 22 applications per week, on the basis of a 50% approval rate, which also needs to take into account the drop-out rate after application.

Table 1 - Monthly analysis



	Oct 2012	Nov 2012	Dec 2012	Jan 2013	Feb 2013	Mar 2013	Apr 2013	May 2013	June 2013	July 2013	Aug 2013	Sept 2013	Oct 2013	Nov 2013	Dec 2013	Jan 2014	Feb 2014	Mar 2014	Apr 2014	May 2014	Jun 2014	July 2014	Aug 2014	Sept 2014
Applications Received: Total 729	11	28	20	28	23	39	21	24	30	35	17	19	22	40	22	35	29	32	39	48	48	47	35	37
Applications Approved:Total 333	0	3	8	9	12	10	13	11	12	9	7	10	7	21	7	16	17	20	17	27	25	29	31	12

4.3.3 Approval rates

When Microfinance Ireland was established in 2012, the original assumption regarding rates of approval was 50% of applications would be approved. From commencement date to Q3 in 2013, the approval rate was running at just under 50%.

The approval rate (Table 2 below) since launch phase now stands at 57% in application terms and 41% in value terms. Since Q4 of 2013, the approval rate has been on an upward trend to over 60%. Indeed, the most recent quarter being reviewed (July to September 2014) has seen a significant rise in the approval rate to 73%.

A 73% approval rate from MFI appears on the high-side for applications that have already been declined a bank loan. Furthermore, despite the fact that over half (56%) of the number of applications are now coming directly from applicants (with no assistance from a Local Enterprise Office), compared to 38% in Q3 of 2013, the overall approval rate has increased. The Department would not have expected that an increase in direct applications would occur at the same time as an increase in overall approval rates. The approval rate of these direct applications is relatively high at 55%. While these applicants may be obtaining assistance from other private sources, it is nonetheless noteworthy that such a high approval rate prevails.

In the light of these high approval rates, the fact that the microenterprises are unbankable and because of the absence of security (i.e. 'the safety net'), when a microfinance loan defaults, the ultimate write off tends to be high and this is a matter of concern. Given the high risk nature of unsecured microfinance lending to start up and young businesses and as evidenced by the previous experience of microfinance in Ireland (Firststep) and Europe (default rate circa 45%+

and bad debt rate of 25%+), the management of credit policy is critical to success. Higher approval rates raise the possibility of higher defaults in this risky sector of finance.

DJEI considers that MFI's decisions regarding its loans should be based on quality applications and MFI's Risk Appetite to take on such loans. Credit quality should not be undermined by an overly risky approach being accepted based on a desire to achieve a target for the number or value of loans approved and drawn down, at the expense of the quality of the credit. The Department is conscious of the MFI Board's concerns about maintaining rigid credit policy oversight and guidelines and recommends that the MFI Board closely monitor the approval rates in order to ensure that the loans provided are fully consistent with the organisation's overall risk appetite.

Table 2: Approvals by Quarter **

		Total Applications Processed							
		Launch Phase	**Q2 2013**	**Q3 2013**	**Q4 2013**	**Q1 2014**	**Q2 2014**	**Q3 2014**	**Total**
		1st Oct12 to 31st Mar 13	1stApr 13 to 30thJun13	1st July 2013 to 30th Septembe r 2013	1st October 2013 to 31st December 2013	1st January 2014 to 31st March 2014	1st January 2014 to 30th June 2014	1st July 2014 to 30th Sept 2014	**1st October 2012 to 30th Sept 2014**
1	Total Applications	149	75	71	84	96	135	119	**729**
2	Total Value	2.78	1.297	1.288	1.374	1.642	2.368	1.852	**12.606**
3	Applications Processed	102	77	60	57	78	107	99	**580**
4	Approved	43	35	26	35	53	69	72	**333**
5	Approval Rate (Number of Applications)	42%	45%	43%	61%	68%	64%	73%	**57%**
6	**Approved**	**700**	**543**	**347**	**569**	**863**	**1119**	**996**	**€5.137M**
7	**Approval Rate (against Value)**	**25%**	**42%**	**27%**	**41%**	**53%**	**47%**	**54%**	**41%**

**** From time to time an application is approved in a quarter and the entrepreneur may choose to withdraw following approval but prior to drawing down. This can result in revisions to previously published quarter-end figures.**

4.3.4 Performance by Loan Size

Table 3 below shows the number of loans issued categorised by size. It shows that the average loan size is €15,400. The original assumptions on loan size when submitting this proposal to Government in 2011 were based on an average loan size of €16,000. Performance to date has shown that the average loan size is broadly in line with the original assumption.

Table 2 - Loan Size

Loan Size	
Euro	**No. of Loans**
≤25k	115
≤20k	39
≤15k	53
≤10k	67
≤5k	59
Total	333
Average loan size €15.4K	

The Department considers that performance to date being in line with assumptions is a positive reflection on the accuracy of the initial presumptions and foresees continuity of this model delivery in line with these predictions.

4.3.5 Performance by size (measured by number of employees) of microenterprise

Table 4 below shows the employment size profile of MFI loan clients at the time of application, the average number of jobs per loan and the total number of loans approved.

Table 3 - Employment Numbers of Microenterprises

Employment Numbers of Microenterprises		
No. of Employees	Total (1 Oct 2012 to 30 Sept 2014)	% of overall
1	160	48%
2-3	116	34%
4-5	33	10%
6-9	27	8%
Average No. of Jobs per Loan	2.3	

The largest element of MFI loan support is going to enterprises with 3 or less employees (82%). This is to be expected as MFI is actively trying to support unemployed people to start their own business and currently offers a small loan of €5,000 to Back to Work Enterprise Allowance recipients to support them start their own business. This has led to 58% of its approvals being provided to start-ups and this clearly is in line with the Government's entrepreneurship agenda.

Also as indicated earlier in the review microenterprises have on average less than 2 persons engaged according to CSO data, so the level of loans going to the smaller microenterprises is to be expected. 83% of approvals were granted to businesses employing 3 people or fewer. This would appear to be broadly representative of microenterprises.

The possibility of MFI supporting pre-revenue generating micro enterprises was raised by some of the stakeholders during the course of the review. The Department of Jobs, Enterprise and Innovation considers that MFI should examine if it is in a position to offer loans to companies that are pre-revenue by offering moratoriums for a number of months, bearing in mind the MFI Credit and Risk Policy. A small proportion of the overall loan portfolio could be considered for this purpose. Establishing a pilot initiative might be appropriate. The Board should make an early decision on this point.

4.3.6 Performance by Geographical Spread

Details of the geographical spread of loans are contained in Chart 1 below. There was a wide geographic coverage of loans with 24% of loans granted in Dublin and 76% in the rest of

Ireland. This is broadly in line with the geographic distribution of the general population demographic shown by Census 2011. This is to be welcomed as it shows that the MFI message is reaching all parts of the country and is generating activity in all counties.

Chart 1 - Loans by Regions

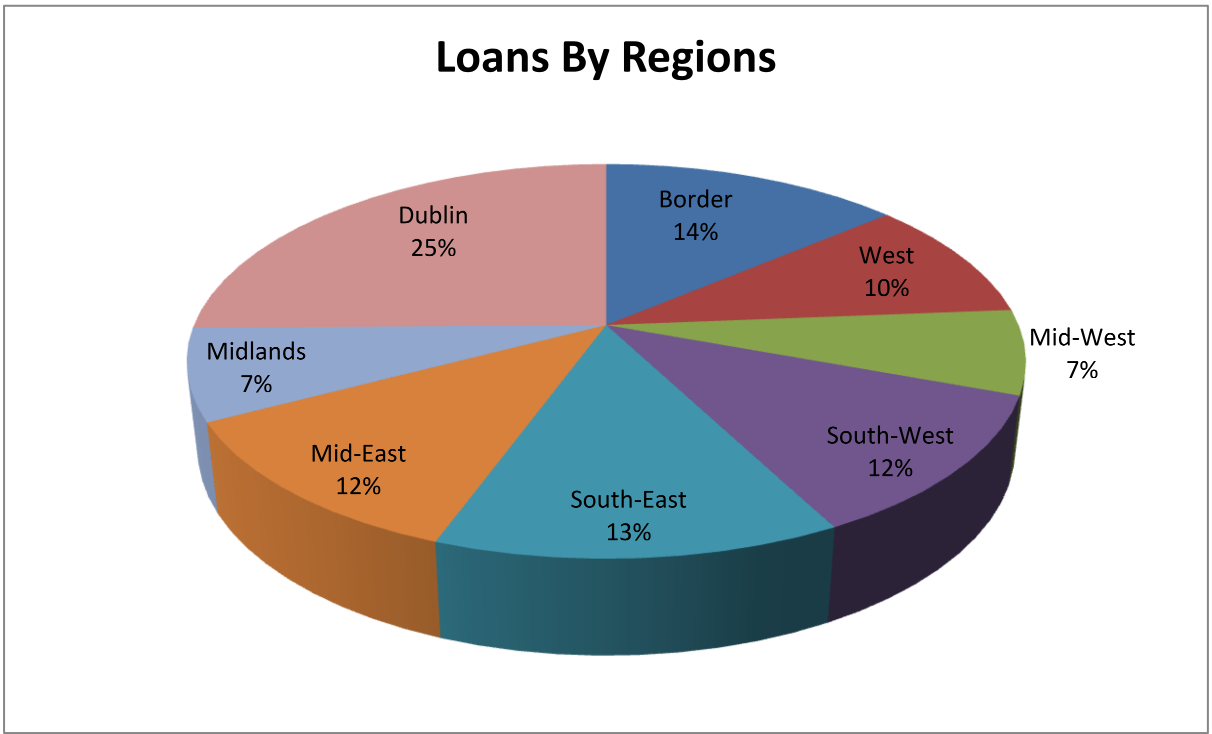


Table 5 - Approval Rates by County

Approval Rates by County							
	Received	Approved	% Approval Rates		Received	Approved	% Approval Rates
Dublin	173	84	**49%**	Monaghan	21	7	**33%**
Cork	65	27	**42%**	Laois	19	8	**42%**
Limerick	39	17	**44%**	Westmeath	18	10	**56%**
Meath	33	14	**42%**	Waterford	17	10	**59%**
Wicklow	31	16	**52%**	Roscommon	17	6	**35%**
Tipperary	29	10	**34%**	Donegal	17	9	**53%**
Wexford	28	10	**36%**	Carlow	16	9	**56%**
Galway	26	13	**50%**	Clare	15	6	**40%**
Mayo	23	14	**61%**	Sligo	14	10	**71%**
Cavan	23	13	**57%**	Leitrim	11	1	**9%**
Louth	22	6	**27%**	Longford	10	2	**20%**
Kerry	22	12	**55%**	Offaly	9	5	**56%**
Kildare	22	9	**41%**	Kilkenny	9	5	**56%**

However, the Department is particularly concerned about the absolute number of applications and approvals (Table 5) from some counties. MFI has received a low number of applications from Leitrim (11), Longford (10), Offaly (9), and Kilkenny (9) and MFI has approved very few applications from Leitrim (1), Longford (2), Louth (6) and Monaghan (7). It is noted that the Board of MFI maintains a close eye on these rates. It is clear that in the future the Board will need to place greater emphasis on improving the performance from these poorly performing counties. It may be possible to do this with the help of the LEOs in the counties concerned which could provide further supports to potential MFI applicants.

4.4 Revised Targets

In October 2013, the Chairman of MFI wrote to the Minister for Jobs, Enterprise and Innovation, submitting revised activity levels based on the experience of MFI during its first year in operation.

Table 6 - Revised Targets (October 2013)

Revised Forecast Figures (Oct 2013)	2012/3 (Actual)	2013/4	2014/5	2015/6	2016/7	Total
No. of Applications	239	382	611	978	1790	4100
No. of Companies supported	107	171	274	438	810	1800
No. of Jobs	237	379	410	620	954	2600

Revised Forecast from MFI (Oct 2013) - (based on 60% increase in applications up to 4100 applications)

MFI reported (see Table 6 above) that the expected pent up demand that was envisaged at the launch of the Scheme was significantly lower than expected. Following submission of its revised figures MFI indicated there was a potential market base for growing the number of applications by approximately 60% each year. Based on this growth in applications, MFI estimated that this would generate total lending approvals of €30 million over five years from 2013-2017 with a total of 4,100 applications being received over this period. MFI estimated that it would support approximately 1,800 companies and 2,600 jobs in the 2013-2017 period. The original business case figures had forecast over €40m in lending and supporting 2,750 companies and 3,850 jobs over a five year period. The Department acknowledged MFI's view in Autumn 2013 and considered that the revised figures provided by MFI were realistic given that the demand expected at launch had not emerged.

MFI has exceeded its October 2013 revised figures for 2013/4 (see Table 7) in number of applications 829 (+28%), number of companies supported 333 (+32%) and number of jobs supported 743 (+34%). Recent figures indicate a further increase in applications driving the organisation forward. While this development is to be welcomed and MFI is to be commended for continuing to drive applications the Department considers that the Board need to keep a close eye on default rates for the reasons set out above.

Table 7 - Revised Targets (November 2014)

Revised Forecast Figures (Nov 2014)	2012/3 (Actual)	2013/4 (Actual)	2014/5	2015/6	2016/7	Total
No of Applications	239	490	784	1123	1464	4100
No of Companies supported	107	226	295	473	699	1800
No of Jobs	237	506	426	684	747	2600

Actual and Revised Forecast Nov 2014 - (based on 60% increase in applications up to 4100 applications)

Finally, as noted in chapter 2 on the basis of the size of the market for microfinance in Ireland the Department is of the view that the original ambition of supporting 7,700 jobs and lending €90 million over 10 years is feasible.

4.5 Staffing in MFI

The issue of Staffing and Human Resources (Paragraph 14 of the Scheme) was discussed with MFI in the course of this review. Initial staff requirements based on predicted loan applications, default collections, establishment requirements and early promotion activities were 9.2 full time staff equivalents. This included 2 full time assessors and 1.6 collectors based on the volume of loan applications. This was always expected to be the primary driver of costs, workload and staffing levels. The original staffing requirements were crafted on an assumption of 1,100 applications being received and 550 loans being approved per annum with 139 assessments of applications and 46 drawdowns of loans being processed each month. These projected application figures have not materialised and MFI is currently processing an average of 40 applications per month. This is likely to continue to improve and will be monitored and kept under review.

The Q3 2014 figures show that MFI received 119 applications over this period. A total of 99 applications were processed and 72 applications approved during the same period, i.e. an approval rate of 73%. In recent months MFI has introduced an improved loan offering of a lower % loan interest rate offering to those applications which originate from the LEOs. The aim of this is to encourage applicants to seek support from the LEOs in developing a robust business plan and, therefore, a stronger loan application. It is expected that this will generate additional activity in 2015.

Up until end September 2014, a total of 5 businesses of the 333 supported by MFI had failed with 3 of those failures arising in Q3 2014. MFI has indicated that the numbers of distressed loans are increasing as the earlier loan portfolio begins to mature and has indicated that this could place work pressures on staff in dealing with and assisting distressed customers. The promotion of MFI at various business and public sector events around the country requires attendance of MFI staff on an ongoing basis and also places resource demands on MFI.

The growing loan book, the changing profile of applications and loans and defaults and the requirement to promote MFI will all continue to impact on the work load assigned to staff in MFI. The Department of Jobs, Enterprise and Innovation is aware of this and will keep the staffing levels of MFI under regular review with the Board of MFI. It will consult with the Department of Public Expenditure and Reform in the event that there is a need to address the current arrangement under Section 19 of the Act in light of changing circumstances including any increase in applications, loans, defaults or other market changes.

4.6 Promotion and Awareness

MFI has been engaged in a wide number of promotional and advertising activities since its inception. These activities have assisted MFI in getting its message out to a wide number of business organisations and individuals that may be interested in its product. At the time of launch, the MFI Communications Plan recognised that there was a wide target market that needed to be reached including microenterprises, Enterprise Agencies, Business Representative Organisations, Elected Public Representatives, Media and the general public. The Communications Plan stated that all potential information channels would be availed of to promote MFI in order to achieve the overall aim of jobs and credit flow to microenterprises. Awareness measures and information actions were to be undertaken at the most appropriate level to ensure that publicity activities were focused at relevant target groups. Information and publicity activities were to be targeted, informing media nationally and locally about the role of the new Body and the Government's initiative in this area.

Promotional activities undertaken to date have included attending various business conferences and events, publishing press articles and case studies, videographies on the MFI website, a Facebook page and a Twitter account. MFI has also been active in advertising its services through regional and national radio advertising and other national and local advertising. The radio advertising seems likely to have resulted in an increase in interest in MFI.

The RED C SME Credit Demand Survey (April – September 2014) conducted on behalf of the Department of Finance suggests that 46% of the SMEs surveyed are unaware of Government funded support initiatives. Awareness of the Microenterprise Loan Fund and MFI was only 23% among microenterprises. The low awareness levels among microenterprises raises concerns over the type and nature of promotion and communications activities undertaken by MFI to date in order to enhance awareness of the Fund. MFI needs to undertake further work in order to ensure that the appropriate MFI target audience is made aware of the MFI product. In order for this to be achieved the Department recommends that the Board of MFI re-examine and where necessary update its communications and marketing strategy to ensure that MFI is optimising its advertising and promotional campaigns.

The Department would also question about the short term nature of the benefits of radio advertising and the substantial costs involved. The Government SME Communications Group Audience Survey results suggest that only 20% of SMEs consider the radio as an effective communications channel which they use, with websites and information packs being viewed as more popular amongst the SME community. The Board of MFI might consider its position on such an approach.

As mentioned earlier the Department is concerned at the low number of applications coming from female, young, senior and migrant entrepreneurs. To enhance take up in these key segments of its target audience the Department considers that there needs to be further engagement with organisations including, the Irish League of Credit Unions, Solas, and the G.A.A., as discussed at 4.3.1 above.

The continued engagement by MFI with the LEOs, the banks and through attending various business events and conferences in raising awareness of their services will remain crucial in ensuring that microenterprises are aware of the Fund and MFI loan offering. The proposal to remove the need for a bank decline will require further advertising and promotional work to be undertaken by MFI in order to ensure that potential MFI customers are fully aware of this change and that the number of loans are increased accordingly.

The Department is therefore recommending a renewed focus on communications and marketing, particularly at local level, and in partnership with the Local Enterprise Offices, to ensure increased levels of awareness and applications from microenterprises.

4.7 Bank Referrals to MFI

Microenterprises which have been refused bank credit for less than €25,000 are all potential clients for MFI. However, many microenterprises on a decline from the banks do not take the next step and apply to MFI for a loan. The transfer of bank refusals to MFI is an issue which has been of concern to the Department and the Board for some time. Indeed, pilot activities were initiated to grow the numbers at the Minister's request to transition this key group from the banks. Unfortunately, these initiatives have had no real success to date. Action needs to be taken to ensure a smoother transition for a refused bank applicant to seek support from MFI. To optimise outcomes the Department considers that it would be ideal if all loan applications refused by the banks could be sent to MFI for their consideration and appropriate action. This could be addressed in a more proactive manner by the banks and the Department considers that to achieve this, banks could give consideration to appointing an appropriate official, who will be responsible for MFI liaison, or putting in place an appropriate system of direct referral.

The appointed official could be tasked with ensuring that all declined bank loan applications reach MFI, or with putting in place an appropriate system of direct referral. The Minister for Jobs, Enterprise and Innovation has engaged at the most senior level with the banks to achieve this and has received positive indications from the banks on this point. To move this to finalisation MFI could now engage directly with the banks in order to introduce the proposal without delay.

Some stakeholders indicated during the course of the review that a change could be effected to the standard loan application forms to allow customers to tick a box and permit applications to be automatically forwarded to MFI, in the event of a bank decline. Such an exercise would overcome any data protection concerns relating to the transfer of information. This could be done by having a small change to the current standard loan application form.

The financial institutions have indicated that there would be extra costs placed on them in the event that any automatic referral system is put in place. Such expenditure is likely to be in relation to updating application forms, I.T. systems and the manpower involved in this. However, the Department considers that such costs are likely to be relatively minimal and that the Banking & Payments Federation Ireland should be requested to action this without delay. The bank referral process put in place would benefit from the inclusion of targets, achievement of which are measured on a quarterly basis and reported on to the Department.

Summary of main conclusions and Recommendations:

- In order to support Government Entrepreneurship Policy MFI should continue to target start-ups, and youth, female, migrant and senior entrepreneurs, in accordance with its Credit Policy.
- MFI and the LEOs should work to increase the pipeline of applications to MFI.
- The Board of MFI should continue to monitor and amend accordingly its Credit Policy and Risk appetite to ensure an appropriate level of loan approvals are made.
- The Department concluded that the average loan size of €15,400 is broadly in line with expectations. The Department, MFI and its Board will continue to monitor average loan size.
- The Department concluded that performance by size of microenterprise was in accordance with expectations. In addition, the Board of MFI should decide on whether MFI should run a pilot for pre-revenue microenterprises.
- The Department concluded that while there was a broad geographical spread, it would be in line with Government policy for MFI, in conjunction with the relevant LEOs to target the regions to ensure lower performing counties increased loan numbers, while continuing to ensure that all credit applications are afforded the same level of rigorous scrutiny.
- In relation to revised targets (Autumn 2013) and performance since then, the Department is of the view that the 10 year targets of 7,700 jobs and lending of €90 million is feasible. However, the Board of MFI needs to closely monitor the quality of loans approved and defaults, to ensure the appropriate balance is reached between approvals and reaching a target.
- MFI, the Department and the Department of Public Expenditure and Reform will continue to regularly review the staffing requirements and if necessary will make a new arrangement for the purposes of section 19 of the Act. MFI and all stakeholders should take all necessary steps to promote and raise awareness of MFI and its loan offering.
- MFI should continue its work with the banks and the Banking & Payments Federation Ireland to establish a system of direct bank referral of declined microfinance loan applications to MFI.

5. Summary of main actions to be taken as a result of this Review

The foregoing review contains a number of conclusions and recommendations in relation to the operation of the Act, the Scheme and the performance of MFI. The main ones are set out at the end of chapters 2-4. The purpose of this chapter is to set out the main actions to be taken as a result of this Review, and will act as the broad roadmap for the actions to be taken to improve the take-up and impact of the Microenterprise Loan Fund run on behalf of the Minister by MFI.

5.1 Remove the refused bank credit requirement from the Microenterprise Loan Fund Scheme (S.I. No. 343 of 2012).

The Department will remove the requirement for a bank refusal from the Scheme, which will allow microenterprises to apply directly to MFI. (This involves amending Paragraphs 3 and 6 of the Microenterprise Loan Fund Scheme, S.I. No. 343 of 2012). This will be pursued by the Department in Q2 2015.

5.2 Amend the Microenterprise Loan Fund Scheme (S.I. No. 343 of 2012) to provide a more flexible and adaptable framework for the Board of MFI to work within.

The Department will revise the Scheme to ensure that the Board of MFI has greater control, flexibility and ability to adapt to market needs, without the need to seek amendments to the Scheme. (This includes amending Paragraph 6 of the Microenterprise Loan Fund Scheme, S.I. No. 343 of 2012). The Board will make an appropriate document setting out the framework, which will be approved by the relevant Ministers. Any future amendments to this framework document will also require approval by the relevant Ministers. This will be pursued by the Department in Q2 2015.

5.3 Introduce an automatic referral system to MFI for all bank declined loans which fall within the loan limits offered by MFI.

MFI will work with the banks and the Banking & Payments Federation Ireland to establish a system whereby appropriate microfinance loan applicants are referred to MFI for consideration. This will build on the work already undertaken and should be pursued throughout 2015 to conclusion.

5.4 Continue with promotion, advertising and awareness raising of the Fund by MFI, to include the targeting of specific segments and counties through a revised communications and marketing strategy, to include local level plans which are developed in consultation with Local Enterprise Offices.

MFI will redevelop its communications and marketing strategy by end Q2 2015 and submit it to the Department and will pilot some more innovative techniques throughout 2015 to reach out to its target audience in order to increase awareness of MFI and its product offering. This will include targeting young entrepreneurs and promoting a dedicated Youth Fund, operated in partnership with the Local Enterprise Offices and Youth Non-Governmental Organisations.