



Chapter 4 - FINANCING OF A BUSINESS

4.2 MICROCREDIT

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What is a Microcredit?

The European Commission defines Microcredit as

“the extension of very small loans (micro-loans) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable. It contributes to economic initiative and entrepreneurship, job creation and self-employment, the development of skills and active inclusion for people suffering disadvantages”¹.

Microloans do not exceed 25.000 Euro.



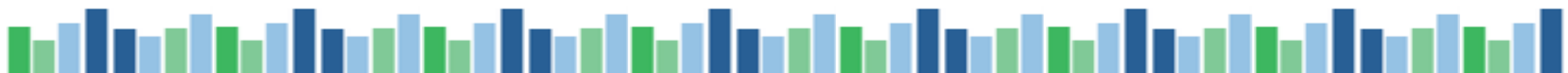
Regular Business Loans vs. Microloans - What's the difference?

A conventional **business loan** consists of financing obtained from a financial institution such as a bank or credit union. The requirements for obtaining a conventional business loan from a bank are established by each individual bank. For instance, certain documentation is required when applying for a conventional business loan and creditworthiness is very important. Therefore, a majority of banks require a personal guarantee from the person applying for the business loan.

A **microcredit** is addressed to non-bankable people starting their own business and access to financial services to be economically and socially integrated in the society. There are two types of micro loans:

- a business microloan is a loan under EUR 25 000 to support the development of self-employment and microenterprises, while
- a personal microloan is a loan under EUR 25 000 to cover a client's personal consumption needs such as rent, personal emergencies and education.

¹ <http://www.european-microfinance.org/index.php?rub=microfinance-in-europe&pg=microfinance-and-eu>



Microcredit

Microcredit' strengths:

The strengths of microcredits can be summarized as follows:

Startups with no credit history or businesses with other risk factors can qualify for a credit-builder microloan.

The microloan approval process often takes the business's story into consideration, even if the busi-

Microlenders usually offer value-add services like education, training, help with marketing plans, and

In the European countries microcredit is regulated under the laws governing the institutions that provide it, basically banks and non-banks. It means that it differs from country to country. You can find more information on Microcredit in your country here:

Be prepared and have a look at the most important step to apply for a microcredit loan on the next pages



Procedure to apply for a microcredit loan

1° STARTING THE MICROLOAN PROCESS

Microcredit is a type of alternative financing for those who do not have access to financing because they have been socially or financially excluded. Collateral is not often required, so microfinance institutions try to build trust with the borrower in order to have confidence that the loan will be repaid. Often entrepreneurs will participate in training or one-on-one tutoring to build this trust and to give the microfinance institution an opportunity to know you and your business plan.

2° ENTREPRENEUR'S PERSONAL INTERVIEW

Usually when you apply for a microcredit, you will have a personal interview and fill out an application with your personal history and data. The collection of data in this stage is fundamental and it will be the base to be able to complete your financial file. You will then use this data to create your personal business and financial plan.

Interview Content:

- **Personal Information:**
 - ✓ Background: How long have you been in Europe, how did you get here, where have you lived.
 - ✓ Family: Civil status, dependents, family situation and other information.
 - ✓ Education:
 - Basic, Medium, University
 - Business related
 - Education in business management or similar
 - Other studies, courses, diplomas etc.
 - ✓ Professional Experience: Special emphasis on business related experience.
 - ✓ Other data of interest
 - Drivers license:
 - Any other skills
 - ✓ Economic and Ownership Data



Procedure to apply for a microcredit loan

INCOME
Salary 1:
Salary 2:
Unemployment benefits:
Pension:
Help:
Rental Income:
Others:
Total:

FAMILY EXPENSES
Rent/Mortgage:
Pension:
Loan 1:
Loan 2:
Loan 3:
Loan 4:
Others:
Total:



- **Economic Data**
 - ✓ Ownership and Indebtedness
- **Business Data**

The loan officer will want to understand your experience and establish your degree of knowledge and involvement in your business. They may ask some of the following questions, which you should be able to answer clearly and with confidence.

- ✓ Business Idea. What is it? How did it come about?
 - ✓ Knowledge of the business, industry, suppliers, competition. What have you developed? Why do you have this knowledge? Do you have access to suppliers? To the customers? What kind of competition is there in the area?
 - ✓ Business location:
 - Monthly rent
 - Deposit
 - Do you need to renovate the premises? Amount needed? Have you negotiated with the owner to assume part of the cost?
 - Review of the contract: Terms, entrepreneur's obligations
 - ✓ Investment Plan/Financing:
 - Verify own resources
 - Reasonableness of Investments. Second Hand? New?
- ! Don't forget: Deposit, licenses, amount for construction to get started, signature etc...
- ✓ Review expenses. Are all the necessary expenses included?



3º DOCUMENTS NEEDED FOR ENTREPRENEUR'S FILE

The loan officer will review and analyze your business and financial plan and will ask for a number of documents to verify your information. The file is the collection of the necessary documents to continue with the evaluation process and to certify and prove the business plan in some way. It is divided into the following items:

Personal File:

- **Identity Card Number**
- **Income Tax Returns.** In the event that you are not required to do one, the document of no obligation to declare.
- **Document of degree of disability** (if applicable)
- **Official work record.**
- **Credit Report.** For example, a document showing the “Central risk information” (CIRBE) is a document that can be requested in Spain, in the Central Bank where debts incurred of 6,000 € or higher are shown. It is the entrepreneur’s responsibility to request it and give it to the loan officer, if available.
- Personal and mortgage loans receipts if any.
- Letter of reference from a known person or previous employer (Previous boss or supervisor, Children’s school head master/ head mistress, pastor of the church, official, etc.)

In some instances it is necessary to request more information to verify your information.

- Bank transactions for the last 6 months
- Justification of the family expenses, if any
- More letters of reference
- Others

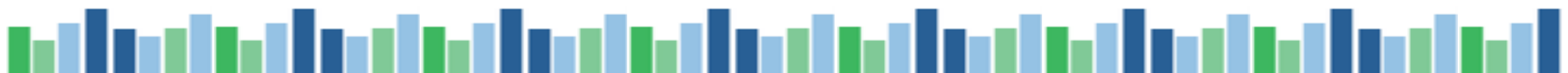
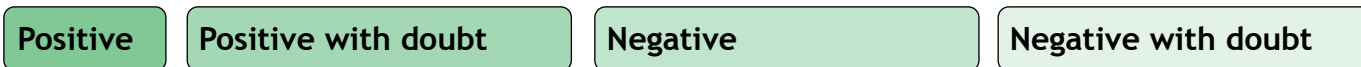


Financial File (Business)

- Business Plan
- Registration in the social security for self-employment
- Permits, certificates and business licenses.
- Invoices for purchases and investments already made
- Proforma Invoices for expenses that will be done with the financing
- Justification of own resources

4° TECHNICAL EVALUATION

Once all of the documents are compiled, the loan officer will analyze all the information included in them. The main focus should be the fact that all the information makes sense. At the end of the process, the loan officer will give an opinion about the case through the “credit evaluation card”. In this card there are some options, including:



5° CREDIT COMMITTEE

Definition

With the opinion of the loan officer, the credit committee will make a final decision on your loan application. The committee is created to carry out the concession or denial of microcredits and to ensure objectivity in the evaluation of the microcredit. This committee will have the authority to make a decision on the approval or denial of a loan, as well as the conditions that it should follow.

Each application is considered on a case-to-case basis, according to the entrepreneur, their business plan and their financial situation. Decisions are individualized, taken case by case and considering all the circumstances presented as mentioned above.

