Institution: University of Salford		
Unit of Assessment: 17		
Title of case study: The European Code of Good Conduct for Microcredit Provision: expanding the scale of microfinance through improved sector self-governance		
Period when the underpinning research was undertaken: January 2005 – December 2019		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Prof. Karl Dayson	Professor of Sociology; Pro-VC Research (from December 2019)	July 2000 – Present
Dr Pål Vik	Senior Research Fellow in Sociology	April 2007 – Present
Period when the claimed impact occurred: January 2014 – December 2020		
Is this case study continued from a case study submitted in 2014? N		

1. Summary of the impact

Although microfinance is recognised as a tool to promote self-employment and inclusion among disadvantaged groups in Europe, its impact is limited by a lack of scale and low financial self-sufficiency for microfinance institutions (MFIs). To address this, the European Commission contracted Dayson and Vik to develop a microfinance code of conduct based on their research into appropriate standards and self-regulatory frameworks for microfinance in the developed world. The Code has been adopted by 53 MFIs across 19 countries, and the European Union now requires compliance with it in order for non-bank MFIs to access microfinance funding. In addition to influencing national legislation and trade body recommendations, adoption of the Code has resulted in larger and better funded MFIs with stronger reputations, greater accountability and improved oversight. Services are now provided in a more consistent and transparent manner to customers whose rights are unevenly covered by existing regulation within different European countries.

2. Underpinning research

Since 2004, Dayson and Vik have, at the research centre Community Finance Solutions (CFS), conducted research into viable and effective models for microfinance institutions (MFIs) in Europe. Dayson compared the financial performance and staff time use (from timesheets) for four UK MFIs (2004) **[3.1]** and Dayson, Vik and colleagues conducted a comparative analysis of the efficiency and sustainability of five UK MFIs (2007 – 2008) **[3.2]**. Among the first and most detailed studies of the business and operating models of MFIs in Europe, these studies provided key insights into the nature and determinants of financial sustainability of microfinance in developed economies:

- The operating environment for MFIs in European nations differs from those in the developing world. In Europe, the potential market is smaller, due to lower self-employment rates and highly developed financial sectors. Income generation is restricted because consumers are more price-sensitive and interest rates are often subject to caps **[3.1, 3.2, 3.3]**.
- There is significant variation in the financial performance across MFIs in the same context due to differences in pricing, scale, efficiency and productivity **[3.2, 3.4]**. Hence standardisation and sharing good practice can improve performance **[3.1, 3.2]**.

As further evidence of their contribution to the field, Dayson coedited the first research handbook on European microfinance (2010) and was among the founding members of the European microfinance research network (2005). Together with Vik, he was awarded the 2008 European microcredit research award for their benchmarking study **[3.2]**.

Following this work, the European Commission awarded Dayson and Vik a contract in 2010 to draft the European Code of Good Conduct for Microcredit Provision. As a result, Dayson and Vik started conducting research into self-regulatory frameworks focusing on two areas:

- **Operating standards for European MFIs:** The first part focused on developing standards appropriate for the European context. The overwhelming majority of existing standards have been intended and designed for the developing world. Dayson and Vik conducted an extensive review of more than 70 existing standards on governance, customer protection, management information systems, risk management and reporting standards. They then tested the applicability of these international standards through a series of stakeholder workshops that discussed the standards in terms of fit with existing legal frameworks, cost and resource implications, and effectiveness. The authors subsequently piloted the proposed standards with 12 European MFIs (2011 – 2012). More recently, Dayson and Vik led the drafting of social performance standards (2016 – 2017), which were incorporated into the Code in 2020 as part of a consultation. This project involved adopting and adapting relevant practices from international social performance frameworks through a series of practitioner roundtables. This was the first ever systematic analysis of the appropriateness of international microfinance standards in the developed world. Once combined, this work revealed that international standards are often ill-suited to the European sector because MFIs in this market focus on riskier, smaller and more marginal client groups, and are also smaller and less mature compared with their developing country counterparts **[3.5, 3.6]**.
- **Role and effectiveness of self-regulation:** More broadly the research focused on how the Commission could develop an effective self-regulatory framework for the Code. Dayson and Vik analysed the existing international frameworks in terms of validation of compliance, allowance for differentiation by type of institution, mechanisms for dealing with non-compliance and whether they generated a quantifiable rating for MFIs. Hitherto, this was the most extensive review of international standards in microfinance. The research concluded that the effectiveness of self-regulation is hampered by the lack of consequences for and enforcement of non-compliance, by an inclination to promote minimum rather than aspirational standards, and a lack of transparency to encourage peer learning and improvements through market discipline **[3.5]**.

3. References to the research

3.1. Quach, H. and **Dayson, K.** (2006) Toward a performance assessment of microfinance institutions in Europe, *Finance and the Common Good/Bien Commun* 25, 61-68. https://doi.org/10.3917/fbc.025.0061 [1]
3.2. Dayson, K., **Vik, P.**, Salt, A. and Paterson, B. (2008). *Making European microfinance more sustainable - lessons from Britain,* European Microfinance Network 5th Annual Conference "Microfinance - a tool for growth and employment", Nice, France (September 2008). Available at: https://www.researchgate.net/publication/317264404_Making_European_microfinance_more_sustainable_-_lessons_from_Britain [2 3 4]
3.3. Goggin, N., **Dayson, K.** and McGeehan (2010). The microcredit sector in the United Kingdom: the role of CDFIs. In *Handbook of Microcredit in Europe*, edited by Carboni, Calderon, Garrido, Dayson and Kickul. Edward Elgar Publishing. ISBN: 9781848441941
3.4. Dayson, K. (2011). Access to finance in deprived areas: has the Government lost interest? pp. 123-141. In *Enterprise, Deprivation and Social Exclusion: The Role of Small Business in Addressing Social and Economic Inequalities*, edited by A. Southern. New York: Routledge. ISBN 9780203817773 [2]
3.5. Dayson, K. and **Vik, P.** (2014). Toward an architecture of microcredit regulation: the case of the European Code of Good Conduct, *Cost Management 28*(2), pp. 18-25. Available at: https://search-proquest-com.salford.idm.oclc.org/docview/1529919752?accountid=8058 [1]
3.6. Vik, P. (2017). What's so social about Social Return on Investment? A critique of quantitative social accounting approaches drawing on experiences of international microfinance,

Social and Environmental Accountability Journal 37(1) (Issue 1: Social enterprise, accountability and social accounting), pp. 6-17. https://doi.org/10.1080/0969160X.2016.1263967 [3 4]

[1]Double blind peer reviewed; [2]Abstract/proposal assessed/reviewed by academic panel; [3]Paper assessed by academic panel for prize; [4]Awarded prize by journal/conference organiser

4. Details of the impact

Microfinance is a growing policy area in Europe due to its ability to promote social inclusion and employment among disadvantaged groups denied access to mainstream finance or employment, such as women, migrants and low-income individuals. Microcredit refers to loans of up to EUR25,000 available to new or existing microenterprises. By 2017, the European microfinance sector had disbursed 635,000 microcredits with a value of EUR2.1 billion per annum. Yet, for the most part, MFIs are still small, dependent on subsidies and lack capacity to grow and become sustainable. To address this, the European Commission identified the need for a code of practice in 2007 to disseminate and promote good practice in the sector. Given the regulatory and institutional diversity in the European microfinance sector, the Commission identified a voluntary code as the best way to set pan-European practices and rights for the benefit of all customers and stakeholders.

4.1. Establishment of a European framework for good practice

Dayson and Vik drafted the European Code of Good Conduct for Microcredit Provision in 2010 – 2011 through a contract with the European Commission. They were invited to tender for the drafting of the Code based on their experience and expertise in microfinance in developed countries and were subsequently awarded a second contract to develop the methodology to assess compliance with the Code (2012 – 2013) **[see 5.1]**. The Code now contains over 150 clauses detailing recommended practices in customer relations, governance, risk management, management information systems (MIS) and reporting. The MFIs signing up to the Code are subject to an external evaluation by the microfinance rating agency MF Rating. In 2014, the EU made compliance with the Code a precondition for accessing European microfinance funding for nonbank MFIs **[5.1]**. Banks were not included, already being subject to significant regulation.

The European Commission summarised Dayson and Vik's extensive contributions as follows: *'The research conducted by Dayson and Vik as part of these contracts significantly influenced the content and process of the Code. Firstly, based on a review of best practices, they developed detailed standards in the themes identified by the European Commission in the terms of reference. Secondly, two chapters were added on the topics of customer and investor relations, and reporting standards and public disclosure on the recommendation of researchers. Thirdly, they influenced the evaluation and award process for the Code, especially the creation, role and membership of the steering group, the evaluation methodology and process, and the importance of external validation and having mechanisms dealing with noncompliance'* **[5.1]**.

4.2. Uptake of the Code and impact on microfinance sector regulation

To date, the Code has led to widespread changes and improvements in the microfinance sector. Out of 138 nonbank MFIs, 53 MFIs (38%) from 19 European countries, including France, the UK, the Netherlands, Romania and Poland, were awarded the Code between 2016 and 2020. This included all the MFI board members of the EU microfinance trade body, the European Microfinance Network **[5.2]**. MFIs, bank partners, regulators and governments see the Code as a best practice framework against which to benchmark MFI performance and practices. There are examples of newly established European MFIs using the Code *'as a blueprint for developing systems and processes to a high standard'* **[5.3]**.

In Greece and Romania, the Code has been used as a template to inform national regulation and practice **[5.3, 5.4]**. On 24 June 2020, the Greek Parliament adopted a new law on microfinance that requires MFIs to be compliant with the Code to be funded under national investment programmes. Organisations that are awarded the Code are allowed to provide microcredit under this law **[5.5]**. In the Romanian microfinance sector, the Code has significantly improved practice and performance through adoption by a leading MFI trade body **[5.4]**.

Romania is among the largest microfinance markets in Europe and has the largest concentration of Code awardees **[5.2]**. According to the Romanian trade body representing 15 MFIs awarded or in the pipeline for the Code, *'there have been many concrete changes resulting from implementing the Code'* **[5.4]**, including greater consistency and transparency in the information provided to customers as well as greater use of customer satisfaction surveys. The positive effects of these changes are *'evidenced by increased customer satisfaction levels and increased membership numbers'* **[5.4]**. The MFIs have put in place more robust processes for dealing with conflicts of interest, management succession planning and board induction and training. *'Taken together these changes have strengthened governance arrangements across the sector'* **[5.4]**. The changes in practice resulting from the Code *'have led to higher performing organisations, better served customers and stronger governance. Overall the Code has led to greater impact through the increase in the number of customers supported'* **[5.4]**.

4.3. Improvements to business practices benefitting MFIs and their customers

Across Europe, '*the Code has motivated the MFIs to revise their practices as a whole, through the lens of the customer, and implement processes that increase their level of accountability'* **[5.6]**. A survey of 42 MFIs from 19 countries shows that 40%-70% have made changes in practice in customer treatment, governance, risk management, reporting standards and MIS to comply with the Code. According to one respondent: *'The Code forced us to have a 360 degree review of our practices (clients protection/communication, governance, risk monitoring.'* Another *'used it as guidelines for development of our institution'* **[5.7]**. MF Rating identified 14 MFIs that have made 28 changes in practice explicitly to comply with the Code, including pricing transparency, customer rights, business planning, risk management and customer complaint procedures **[5.6]**. 13 of the 14 MFIs taking part in an external evaluation of the impact of the Code reported improving their practice as a result of the Code **[5.3]**. MFIs made changes in the following areas:

- **Customer experience:** The Code has brought greater consistency and impacted *'positively in terms of transparency'* **[5.7]** regarding the information provided to customers, even within the same countries **[5.3, 5.5].** Nearly 70% of MFIs surveyed had made changes to customer rights and complaints and information provided to customers, whilst 60% had altered customer complaints procedures **[5.7]**. Four MFIs, interviewed as part of the external evaluation, reported improving their communication with customers through the information provided to customers when applying for loans as well as introducing customer satisfaction surveys. Five organisations changed their complaint procedures to make it clearer and more accessible by putting it on their website and two improved the customer journey **[5.3]**. MFIs also started disclosing effective interest rates and allowing customers to withdraw within 14 days of the granting of the microcredit, thereby placing customers in a better position to make informed decisions **[5.6]**.
- **Business planning:** Nearly 60% of MFIs made changes to their approach to business planning and over 40% altered personnel and management policies **[5.7]**. Three MFIs moved to a 3-year planning cycle as stipulated in the Code forcing them to take a more strategic approach to business planning **[5.3]**. MFIs also started including detailed budgeting and forecasting and incorporated risk assessment in their business plan **[5.6]**.
- **Improved governance:** According to an external evaluation, MFIs enhanced their governance, board performance, oversight and accountability by adding more formal board induction (3 MFIs), recruiting additional board members (3), removing board members (2) and providing more Key Performance Indicators (KPIs) for board members (4) **[5.3]**.
- **Risk management:** Several MFIs improved their risk management, including improving or adding internal audit mechanisms **[5.3]**. Organisations implemented internal audit functions, appointed senior managers to be accountable for risk management and put in place mechanisms to identify, assess and prioritise risks. MFIs started using PAR30, the internationally accepted portfolio quality measure in microfinance, to measure loan delinquency **[5.6]**. Around half of MFIs surveyed changed loan portfolio monitoring and processes for identifying risk, whilst 40% altered/introduced internal audit function.

4.4. Reputational and financial benefits for MFIs

MFIs experienced clear reputational benefits through adoption of the framework due to its requirement for improved governance and accountability. This resulted in increased levels of funding, a larger customer base and strengthened their stakeholder relationships.

- **Enhanced reputation:** Eight out of ten MFIs surveyed reported that the Code had greatly improved or improved the reputation and credibility of their organisations, whilst nearly 70% reported greatly improved or improved visibility of their organisations. For half, the Code had greatly improved or improved their ability to attract new partners. For one respondent *'it offered recognition and appreciation from peer institutions'* **[5.7]**. An external evaluation found that the Code enhanced the reputation of 12 MFIs vis-à-vis external stakeholders. It facilitated establishing and operating partnerships with banks and strengthened the negotiating position by demonstrating the importance of microcredit provision **[5.3]**.
- **Ability to raise funding:** Out of the MFIs surveyed, 32% or 14 providers reported that the Code had improved their ability to access funding. Estimates of impact on funding ranged from EUR250,000 to EUR35,000,000, with one respondent estimating *'an impact of 20-30% of total funding'* **[5.7]**. According to an external evaluation, nine MFIs reported improved access to funding, nine were able to access European funding and three were able to access wider funding as implementing the Code helped with due diligence with other investors. Specifically, the Code requirements meant that MFIs were in a better position to provide more complete information. According to three MFIs, the Code award enhanced their standing and ability to get increased funding from existing investors **[5.3]**.
- **Increased customer numbers and satisfaction:** MFIs reported that improved consistency, transparency and use of customer satisfaction surveys led to greater customer satisfaction and increased customer numbers **[5.3]**. It set apart four MFIs from their competitors by highlighting to their customers that they are responsible lenders **[5.3]**. Out of the MFIs surveyed, 60% found that the Code had enabled them to differentiate themselves in the market **[5.7]**.

Adoption of the Code has resulted in numerous positive impacts on MFI organisational culture, which will also be transmitted to their customers and stakeholders. According to an external evaluation of the Code: *'It is notable that fourteen of the fifteen people interviewed felt that the code had had a positive impact on their organisation or the organisation(s) that they supported. This came across clearly and comprehensively during the interviews'* **[5.3]**. According to MFI survey respondents, the Code had *'improved internal ethical culture'*, *'increased transparency',* had a *'positive impact on staff alignment with the values of the company'* and led to '*better trained employees.'* According to a third of MFIs surveyed, the Code had also strengthened their ability to cope with the effects of COVID-19 **[5.6]**.

5. Sources to corroborate the impact

5.1. Testimonial: European Commission (September 2020), outlining Salford's researchers' contributions to the Code and the EU Code precondition re. microfinance (4.1)
5.2. List: Awarded microfinance institutions complying with the Code (December 2020) (4.2)
5.3. External Evaluation Report: *'Impact of the Code of Good Conduct for Microcredit Provision',* Community Investment Services Ltd (April 2020), on the Code as a blueprint to inform national regulation, (4.2), improved practice, customer experience and KPIs as a result of the Code (4.3), enhanced reputation, ability to raise funding and greater customer satisfaction (4.4)
5.4. Testimonial: CARUTCA, Romania (March 2020), on greater consistency, transparency, customer satisfaction and strengthened Government arrangements as a result of the Code (4.2)
5.5. Greek Microfinance Law (October 2020), requiring MFIs to be compliant with the Code (4.2)
5.6. Testimonial: MF Rating (January 2021), identifying 14 MFIs that have made 28 changes in practice explicitly to comply with the Code (4.3)
5.7. Online Survey: impact of Code on MFIs, conducted on behalf of the European Commission (December 2020), on improved customer experience and changes to business planning (4.3) and reputational benefits and differentiation within the market (4.4)