# Optimal Legal Form and Governance for Microbanks and Microfinancial Institutions: A European Survey

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## The current role of microbanks and other microfinancial institutions in the European crusade against unemployment

Since the approval of the Single Market Act[1] by the European Commission, the Europe 2020 strategy integrates microfinance among the priority policies of the European Union in order to generate self-employment, which constitutes one of the bases of a new economic paradigm call social or inclusive market economy.

Such paradigm, sufficiently consolidated throughout European specialised institutions since the 2007 *European Initiative for Development of Microcredit*,[2] acknowledges the transcendence of small or microenterprises and familiar enterprises for the future of Europe, considering that more than nine out of ten businesses within the European Union operate with less than ten employees.[3] It also emphasises the importance of microfinance—simply but properly definable as the funding and financial services needed by such enterprises, provided with a pro bono social orientation[4]—in the construction of an European economy ready to constrain poverty limits, nowadays threatening more than one out of eight Europeans.

Irrespective of legal regime limitations, specialised financial institutions and intermediaries—sometimes called microbanks—and other lenders oriented to social finance[5] or microfinancing use to deal with a number of typical restrictions tied to the structural characteristics of the loans. Such limitations may be summarily synthesised as follows:

- The need to charge micro-borrowers with interest rates over their usually scarce reimbursement capacity, sometimes even exceeding market ordinary rates, due to the absence of collateral inherent to these socially oriented loans.
- The weakness of the standard information about micro-borrowers at the disposal of the micro-lender or microbank. Such information is essential for the latter, considering that small borrowers starting their business might easily fail and the lender has no real state or financial collateral as a pledge; although microfinance is based upon personal confidence, credit risk subsists and such confidence must be supported by enough and actual relevant information on the evolution and perspectives of the financed business.

[1] Three of its levers (1, 8 and 11) refer to microenterprises and its main obstacles for development: access to funds/ineligibility for loan funding or venture capital; difficulties to find out specific social funding; and lack of societal specific regulation for sole proprietorships, small business (less than 10 employees) and other institutions devoted themselves to microfinance. See EU Commission Staff Working Paper: Ex-ante Evaluation *Accompanying the document* "Proposal for a regulation of the European Union Parliament and of the Council establishing a European Union Programme for Social Change and Innovation", COM(2011) 609 final, 6.10.2012, 11–24; European Parliament Directorate-General for Internal Policies (Employment and Social Affaires Policy Department: *Microcredit networks and existing law legislations with a view to the implementation of the microcredit instrument*, November 2010, 20–28 at *http://www.europarl.europa.eu/document/activities/cont/201106/20110620ATT21878 /20110620ATT21878EN.pdf* [Accessed October 2, 2012];Communication from the Commission to the Council, The European Parliament, The European Economic and Social Committee and the Committee of the Regions of November 13, 2007, "A European initiative for the development of microcredit in support of growth andemployment" Com(2007)708 final; H. Kraemer-eis and A. Conforti,*Microfinance in Europe: a marketoverview*,Working Paper 2009/001, *European Investment Fund Research and Market Analysis*, 1–9; S. Lämmermann, *Evidence from the EMN Overview of the Microcredit Sector in the European Union 2008–2009*, EMN Working Paper, April 2011, 7–40 at *http://www.european-microfinance.org/data/file/Librairy/emn-target-overview-study.pdf* [Accessed October 2, 2012]; B. Jayo, A. González and C. Conzett,*Overview of the Microcredit Sector in the European Union 2008-2009, European Microcredit Network*, Working Paper No.6, June 2010, 1–11; B. Jayo, S. Rico and M. C. Lacalle (Fundación Nantik Lum), *Overviewof the Microcredit Sector in the European Union 2006–2007*, European Microcredit Network (EMN) Working Paper No.5, July 2008, Paris, 1–9; European Microfinance Network/Latham and Watkins: *Microfinance and micro-entrepreneurs in Europe*, 2008, 1–23

[2] This term refers to small loans—up to 25.000 €, according to the EU Commission criteria, which follow the*European Initiative on Microcredit*; Cf. COM(2011) 609 final, June 10, 2012, 12—conceded to entrepreneurs who have no collateral or assets to offer as a guarantee of reimbursement. In general, we might affirm that microloans conceded by banks used to exceed the sum of 10.000 €, and financial institutions other than banks—*microfinancial* lenders—generally lend sums under the aforementioned limit. Irrespective of the amount that is lent, the essence of the microcredit or microloan is the absence of any guarantee, pledge or financial covers that ensure the devolution of the funds, as far as those financial or legal guarantees have been replaced by personal confident of the lender in the success of the financed borrower—see The World Bank—International Finance Corporation—, *Doing Business 2011. Making a difference for entrepreneurs*, November 2010, passim; DG Enterprises and Industry, *The regulation of microcredit in Europe*, Expert Group Report, April 2007, s.2; CGAP, *Microfinance guidelines—principles on regulation and supervision of microfinance* 2003, 5–13.

[3] Cf. Europäischen Zentrums Für Arbeitnehmerfragen (EZA):*Jahresbericht April 2011—März 2012. Bildungsmassnahmen des EZA im Rahmen des europäisch en Sozialen Dialogs*, Königswinter, July 2012, 13–14, at *http://www.eza.org/fileadmin/system/pdf/ Jahresberichte/Jahresbericht_f%C3%BCr_Website_endg_de.pdf* [Accessed October 2, 2012].

[4] Cf. J. Ibáñez Jiménez and A. Partal Ureña, "Responsabilidad social de las empresas y finanzas sociales", in Ibañez (ed), *Responsabilidad social de la empresa y finanzas socials* (Universidad Internacional de Andalucía, Akal, 2004), 45–49; Trustlaw (Thomson Reuters Foundation for ADIE): *Creating Jobs in Europe: Legal and Regulatory Frameworks of Microenterprises and Microcredit in Europe*, September 2011, 6–9; Durán Navarro (ed), *Conclusiones del primer Encuentro Nacional de Microfinanzas y reflexiones sobre los principales elementos de discusión*, 15 Colección Cuadernos Monográficos del Foro de Microfinanzas (Madrid, July 2011), 19–23.

[5] The abovementioned term is equivalent to the use of the financial institutions—financial markets, intermediaries, products and contracts—by persons who do not have access to credit according to ordinary banking standards. It may be affirmed that the social finance is an essential part of the social economy which rests in a pro bono philosophical view and shares the commonly accepted multi-stakeholder assumptions of the social responsibility management and entrepreneurial theories.

- The dispersion and legal variety and composition of the social institutions and entities tied to the microfinancial processes, systematically helping microbanks or lending institutions to complete the aforementioned information about the borrower—essentially, credit history and business financial statements.
- Their financial imbalances derived from the need to support borrowers lacking of equity and bearing complex administrative costs, including business coaching and advisory services, not always covered by microfinance intermediaries or supporting NGOs.

## European compared models of microbanking and its relationship with the optimal societal legal form adopted by microfinancial institutions

The societal and company-law framework for microfinancial institutions,[6] and in particular, for banks or other companies or entities financing small or sole-proprietorship starting businesses, varies significantly from one European jurisdiction to another, comprising a bunch of laws and codification systems. It could be affirmed that most of European banking—and company-law institutions are quite poorly adapted to the rapid changes characterising the contemporary economies—increasing structural unemployment, greater autonomy of small entrepreneurs, prevalence of services linked to de-industrialisation, amongst the main ones. Those legal lagoons and system differences do not impede, but constrain, the development of microfinance, multiplying the negative impact of the main regulatory relevant factor in this area: the formal legal monopoly of banks or credit entities stricto sensu as fund borrowers from the public,[7] and, in some European countries like Germany, as sole and exclusive lenders of the financial system; such legal limitation may reduce the opportunities of microenterprises, borrowers that might have received funds from non-banking lenders: NGOs and, in general, non-company associations and duly constituted foundations according to Member-State law.

### *European compared models of microbanking: generalities*

There are two main models in the European Union: the Romanian or Eastern model, in which microbanks or micro-lenders focus in the profitability of preexisting small enterprises to help entrepreneurs to maintain their business[8]; and the French or Western model, typical of the most financially developed European Member States, where a governmental priority is the financial inclusion of people out of the financial system because of poverty or unemployment. In the Eastern model, microfinancial institutions are supposed to be profitable; according to the philosophy of the Western model, on the contrary, such institutions do not renounce to, nor dismiss, financial profitability, though social sustainability of the funding institution—within the governmental or national economic context—is the main priority, thus eventually sacrificing the short-term profitability of the financial lender by means of rates under market or other. And also eventually, even compromising its financial sustainability, for the social wealth generation is considered the ultimate aim of microcredit and microfinance in the context of Western countries.

### *Analysis of the optimal societal to be adopted by the microlender or financial specialised institution*

#### Private-law associations

Within this scope are to be considered, in most European jurisdictions—in particular, referring to civil-law or continental company-law systems—all those non-profit organisations not ruled by company-law acts or regulations, other than foundations. Such conception of the legal term "association" is actually ignoring the fact of the possible—and actual in some jurisdictions—theoretical framing of companies within the scope of a legal definition of "association" as a private contract of partnership, composed by partner relationships and governed by the rules that these gave themselves to reach their common purpose—essentially, contracting with thirds in markets. Understanding the term "association" as an organisation where profit is not the ultimate intention of the members, it is to be reminded that some associative NGOs[9] have taken the lead in the development and practice of microcredit and micro-lending or micro-funding organisations, as well as in serving as a link between other social institutions of

[6] This expression involves not only Banks or lenders but also intermediaries and third-sector or social entities helping the bank or lender to properly fulfill its aim of generalisation and efficient social diversification of the benefits of finance.
[7] In Spain, this legal monopoly is held by Banks, *Cajas de Ahorro* and credit cooperatives, according to the law in force: Real Decreto Legislativo of June 30, 1986 and the Ley de Disciplina e Intervención de las Entidades de Crédito of July 29, 1989.
[8] In Romania, Patria Credit received in February of 2011 a senior loan of €8 million from Progress Microfinance, initiative from the EU Commission, The European Investment Bank and the European Investment Fund in order to distribute €200 million through microfinance providers; in October of 2011, FAERIFN SA joins that group of providers with a loan of up to € 1 million aimed at improving the financial performance and efficiency of over 200 micro-entrepreneurs, mainly agricultural producers in Transylvania- who receive technical training during the loan life.
[9] In France, the paradigm is ADIE (*Association pour le droit à l'initiative économique*) Cf. EU Parliament (2010), *Microcredit*, 12, well established NGO and one of the pioneers in Europe in terms of microlending structures and specific IMF governance practices, having served more than 30,000 borrowers in 2009/2010. In Western Europe (England, Germany, Spain, Italy, associative forms are the most usually utilised to vehicle microfinance; in Eastern Europe, the associative phenomenon is expanding in recent years, since the widespread of the EU Structural Funds.

the "third sector"—in which the lenders or funders themselves may be included—and microenterprises. The non-profit and social responsibility profile of these institutions makes them suitable to receive massive public aid, in the form of transfers, subventions or tax exemptions and other fiscal benefits.

## Foundations

Statutorily characterised by the definition of a publicly disclosed socially-oriented aim, foundations share with non-company-law private associations the advantages of being ideal candidates to receive public aids, enjoying the confidence of the social sector actors and micro-entrepreneurial community. Besides, they can count on the guarantee of one or more public administrative or state agency supervisors which, by legal mandate, care for the fulfillment of its pro bono proclaimed foundational purpose. As a negative counterbalance is to be noted the magnitude of the administrative burdens derived from such public supervision, sometimes deterrent for lenders to embark on the foundational adventure.

## Non-financial public limited companies

According to the strategies developed by certain NGOs, the optimal type of institution offering financial services to entrepreneurs starting in situations of patrimonial insufficiency or very low income is the one that guarantees the accommodation to the financial needs of the poorest, and that should be a non-financial company in order to avoid prudential supervision, on one hand; but on the other hand, it should not be a foundation of association, in order not to depend on the aims and finalities typical from NGOs and third sector, which are adequate for the entrepreneurs but not for its financers or lenders. Also according to this view, non-banking public limited companies would facilitate the access of investors to this sector, simultaneously avoiding banking supervision, but ensuring the existence of company-law formal capital and societal guarantees and the availability of an optimal corporate governance within its administration organs and structures, which in theory is more difficult to reach in third sector or non-profit organisations. Otherwise, within this scheme there are real partners risking money, which should be willing to reach profitability irrespective of the social aim of the microfinancial entity, thus providing an incentive for efficient governance.

## Other non-financial institutions (silent partnerships, stilleGesellschaft, société en participation, cuenta corriente en participación)

Silent partnership means a double contracting device: on one hand, the banker of microlender appears externally as the one and only formal lender, assuming the whole responsibility for the debts incurred; on the other hand, silent partners—like ONGs or social economy entities—supply the rest of the funds needed for the financial stability of the appearing microfinancial institution but remaining hidden from the public eye, guaranteeing the solvency microfinancial but not assuming any social or corporate responsibility. Such guarantee is provided on the basis of a private contract of partnership similar to a societal or corporate contract among partners, which is unknown to the public (*cuenta en participación, Stille Gesellchaft, société interne*, *silent partnership contract*). The silent partnerships may help microbanking stability and complement eventual inefficiency or insufficiency of public or private formal funding received and/or provided by the microbankers to the microenterprises. The silent partners may remain alien to the microenterprise management and administration or not, and such flexibility may efficiently incentive the microbankers to involve in high-risk starting-up small businesses. The manager of the silent partnership is the formally appearing banking institution, which must share banking profits and losses according to the internal quasi-societal agreements entered into with the hidden partners. This flexible solution is not incompatible with some of the societal or legal forms adoptable by the microfinancial institution.

## Financial—other than banks—public companies

Within this group credit cooperatives and other financial lendersmay be comprised. Among the latter should be considered institutions practicing microcredit activities like those developed by the*Irish League of credit unions*, which formalises links with current microfinancers and which operational control and interest rate setting are exercised by the government according to existing law provisions. It is also the form adopted by some so called *ethical banks* in Italy based upon a cooperative societal model[10] where financing is oriented towards the non-financial (socio-political, environmental, industrial, entrepreneurial, among other) consequences of the funding contracts, including their impact on human promotion and sustainable economic development. In some European jurisdictions, cooperatives have easier access to guarantee schemes—public, private or

[10] The Fiare Banca Etica Group, which cooperative societal system is also called *banca popolareetica*, in accordance with the universality of the potential destination of microcredit and of other microfinance facilities not always accessible under banking law and other non-banking related statutory regulations—Cf. Banca Popolare Etica, Società Cooperativa Per Azioni: *Statuto*, Padova, March 10, 2010 at *http://www.bancaetica.com/Gallery/File/statuto/Statuto%20%20090310%20-registrato%2016_07_10.pdf* [Accessed October 2, 2012]. The model adopted within this group is fusing banks with credit cooperatives; the former being legally deemed to be credit institutions under prudential supervision, but not the latter, which operate under participative societal schemes that regulate dividends for non-cooperative partners, apart from those attributed to cooperative partners.

mutual—which cut down the exposure to the credit risk born by the microfinancing institution. The societal peculiarities of cooperatives facilitate the constitution of mutual arrangements among social or third-sector entities and authorities, compensating the banking-law limitations for the constitution, maintenance and execution of such guarantee schemes. Such peculiarities let lenders move beyond the legal constrictions of ordinary state or governmental-sponsored schemes, typical of national Guarantee Fund provisions. In France, a so called "guarantee fund for economic inclusion" has been designed to cover microcredit default in the case of insolvency of microborrowers, in order to repay the amounts owed to the non-bank lender. The constitution of special statutory and by-law provisions developing a societal regime of these non-banking special microlenders facilitates the public confidence in microcredit, and may be optimally combined with imaginative varieties of counter-guarantees, first-demand guarantees, negative pledges and other preventive remedies against default, and with sectorial particular cover or reimbursement schemes that do not fit at best in administrative and statutory banking classical regime.[11]

## Banks

The legal monopoly of banks as the only possible company-law form is currently in force in countries like Austria, Cyprus, Germany or Hungary. Anyway, microlenders may be banks, so that many microenterprises ask banks for microcredits. Some banks have developed specific microfinancial or microcredit programs, where the lenders do not need to comply with collateral or solvency ordinary requisites. These programs may be developed by specific banking departments or not; they even used to be managed counting on the expertise of participated NGOs or associative entities subordinated to the capital structure of the bank or banking group.

However, the fact that many business or industry associations and providers of microfinancial services mistrust the banks and other for-profit oriented institutions, remarkably handicaps the expansion of microcredit within banks and other supervised financial lenders. That is one key reason explaining why new specific microfinancial institutions have been created, although they are for-profit oriented. Anyhow, it must be outlined that European microcredit is fundamentally supplied by commercial or special institutions formally constituted as banks.

## Administrations and public-sector depending institutions acting as microlenders or as providers of microfinancial services and or administrators of correlative European regional programs

It should be noticed how frequent is in EU jurisdictions—Austria, Denmark, Estonia, Germany, Ireland, Italy, the Netherlands, Portugal, Slovenia, Spain or Sweden[12]—that public administrations directly help new or growing-up micro-entrepreneurs by means of start-up microcredits, start-up grants and public loans, conceded by themselves (Austria), by specialised associations (France, Portugal) or by banks and financial institutions, depending or not from a public administration (Germany, Spain[13]). In some of those cases, the public support means special programs approved by local, regional or state administrations involving under-market interest rates or special returning or reimbursement conditions, which may imply the cession of risks and costs to the social community through the corresponding administrative burdens and eventual losses.[14] In other cases interest rates are over market prices to compensate such burdens and costs, thus guaranteeing efficient public microbanking or microfinancial intervention.

Anyhow, the non-profit orientation of these governmental financial institutions and correlated interventions differs from the one given to micro-funding by private associations or foundations at one crucial point: whilst these NGOs unlimitedly sacrifice associative or private interest to serve excluded persons, public microfinancing entities have to serve at once public interests, thus focusing on generating self-employment or business self-sufficiency.[15]

## *Brief note on the relationship between the economic model and the societal form*

Within the scope of the Eastern model, banks and credit entities are more likely to support preexisting enterprises, seeking profitability. Within the context of the Western

[11] As a sample, the *Cyprus Government Guarantee Scheme* covers loan default in the manufacturing sector; micro-manufacturers are allowed to use this Scheme in case of insolvency or extreme difficulties for restructuring, thus alleviating the strangling in selected high-tech sector-productive units. Since 2010, the EU Competitiveness and Innovation Framework Program 2007–2013 (CIP) extends loan guarantees to non-bank financial lenders to small caps. Such lenders also have at their disposal the program of the European Commission denominated Progress Microfinance.

[12] In this Scandinavian country, ALMI is a state-owned company conceding credits at a rate higher than the one offered by banks, thus ensuring the segmentation of microloan market. To compensate such disadvantage, administrative and collateral facilities are provided within the ALMI contracts and programs.

[13] That is the case of the *Instituto de Crédito Oficial* (ICO), well known in Spain for its long-term experienced command in microcredit programs in concurrence with NGO initiatives. As similar examples we find KfW (Germany), Fonds de Participation (Belgium), ICO (Spain), MFB (Hungary) or Finnvera (Finland), the latter having lent more than10,000 annual credits since 2008. It is increasingly common in the case of municipal or regional administrations reproducing public state programs, e.g. NRW Bank (German Land of Nordrhein-Westphalen); Brusoc—Brussels city.

[14] However, public-sector lenders are not the only ones under inefficiency suspicion; the European Investment, Social and Regional Development Funds have been actually supporting private-sector microfinance institutions. Specific actions have also been taken to support both public and private financers—like the *Join Action to Support Micro-Finance Institutions in Europe* (JASMINE) or the Joint European Resources for Micro to Medium Enterprises (JEREMIE). These programs include non-financial social or technical support and assistance for the financed enterprises—Cf. EU Parliament (2010), *Microcredit* 35.

[15] The competent Directorate of the EU Parliament opportunely emphasises that the strength and weakness of these public entities consist of the same: its dependence on administrative employment or macroeconomic policies and criteria of efficiency, frequently different from poverty alleviation of the borrowers or banking self-sustainability—Cf. EU Parliament (2010), *Microcredit* 13.

model, non-societal forms, particularly foundations and private-law associations, are more likely to fund enterprises conferring priority to CSR criteria, somehow sacrificing short-term benefit.

Societal profit-restrictive forms like credit cooperatives, and silent partnerships and other hidden-investment financing consortia, own a mixture of characteristics that may be useful without distinction in both models. In particular, silent partnerships may increase the potential of banking investment in non-lucrative financers, creating a field of for-profit interest necessary to support the associative or foundational aims, irrespective of the profile of the borrowers or the administrative barriers imposed to banking activity in diverse jurisdictions, mainly in the macroeconomic and entrepreneurial context characterising Eastern financial systems.

## The prerequisites for an optimal governance of European microfinancial institutions

The optimal governance of microfinancial institutions is one of the key factors for the development of the microenterprises, not only in Latin America or Asia, but also in Europe, considering the difficulties these find in order to obtain credit according to normal market conditions. The lack of optimal banking governance means lack of transparence and thus loss of confidence among investors, and subsequent capital flight. Best governance practices in microfinancial in banks as well as in non-banking institutions, brings best attention to the needs of microenterprises, market integrity and client confidence.

The prosecution and conservation of the corresponding managerial excellence must not ignore corporate governance internationally recognised principles nor company law mandatory rules currently applicable in the jurisdiction where the lender is formally established or has set its legal domicile.

Before describing the conditions for an optimal regulation of the microfinancial corporate governance, it should be carefully noted that:

- The discussion on the need to regulate microcredit and microfinancial institutions, coming from the eighties of the past century, is still alive, although the European general trend towards enacting laws on microfinance is consolidating, as is the case in Italy or Portugal, in some jurisdictions in parallel with the development of provisions on small caps or microenterprises (Cf. the European Commission Small Business Act of June 2008).
- It is still exceptional the existence of a formal regulation of the micro-lending societal form and activity. It is unusual to find specific laws governing micro-lenders or microfinancial activity carried out by firms developing it as an exclusive societal activity; until recent years it has been even more rare that such regulations have been conceived apart from the banking system (France, Romania) in order to allow microenterprises benefit from the organic societal and inner-contractual societal or bylaw specificities of the microlender.

The optimal governance of a microfinancial institution requires the fulfillment of a number of prerequisites or conditions of ideal functioning, which contents may be summarised as follows, according to several different operative ambits:

- Relative to the juridical and ethical orientation of the institution
  - — Current and actual limitation of the powers of its representatives according to a principle of interdiction of power abusing. Such limitation should be modulated according to the societal or non-company legal regime of the micro-lender; in all cases, its practical consequence must be a reasonable distribution of powers among stakeholders, according to risks and responsibilities assumed, and the possibility of effectively controlling, ceasing or sanctioning fraudulent or negligent management by representatives.
  - — Permanent orientation to value creation, compatible with the social aims of the institution and, whichever these might be, with the defense of the principles contained in the UN Universal Declaration of Human Rights of 1948 and with UN environmental and internationally accepted corporate social responsibility principles.[16]
  - — Continuous will to cooperate with administrative and judicial authority, mainly in auditing committees—if existing—but also all over the bodies and employees and members of the financial institution.

[16] *UN Global Compact* (2000); Cf. J. Ibáñez Jiménez and A. Partal Ureña, "Responsabilidad social de las empresas y finanzas sociales", in Ibañez (ed), Responsabilidad social de la empresa y finanzas socials (Universidad Internacional de Andalucía, Akal, 2004), 30.

- — Instauration of a full disclosure principle to stakeholders and creation of a personalised stakeholder relations system. Such disclosure should be extended not only to business-related matters—including management remuneration and administration policies- but also to the policies on prevention, monitoring and solution of conflicts among stakeholders, including third-sector or social entities supporting the funding and the micro-borrowers.

- Connected with the competence of managers and the managerial efficiency.
  - — Like all third sector or social-action sector entities, IMFs need personalised and specialised experienced management in order to control specific credit history of borrowers.
  - — In order to efficiently implement governance systems, such personalisation implies minimum bureaucracy inside the institution and pay exhaustive attention to the evolution of every single financed enterprise or individual.
  - — Sufficient empirical evidence has shown governance weakness in microfinance banking governance due to the concentration of functions in one sole director or general manager, for such concentration deflects or diverts the attention that must be paid to single borrowers.[17] Then, functional diversification is required for optimal corporate governance.
  - — Independence—or lack of conflicting interests—of directors from executive managers, and independence of both from the head director or factual leader of the institution, in order to minimise the risks of fraudulent conducts and maximise cross information between managers.
  - — Sufficient independent internal auditing and risk-control structures, according to the size of the loans and the profiles of their beneficiaries and lent or borrowing enterprises.[18]
  - — Independent complementary auditing of the loan receivers is required in order to check the efficiency of the managerial structure of the lender and the regularity and legality of its administration.
  - — Subventions and public aids, if existing, must be transparent and publicly disclosed by managers or directors.[19]

- Linked to the democratic deciding organ of the financing institution (assembly, general meeting).
  - — Effective participation of the assembly members—capital partners or not—in the decisions of the institution. That does not depend only on the will of the members, but on the facilities supplied by managers on meetings, summoning and convening. On-line communications are the technological tools that complement the bylaw or law current provisions in order to the efficient publication of the assembly or general meetings.
  - — Complete reception of timely and relevant information to decide in order to protect the right of information and effectively exercise the faculties and powers of control within the assembly. Webpage and other Internet communication devices are nowadays essential to this end, letting members asking questions on the agenda or suggesting new debated questions on line, respecting company-law or bylaw established rights of managers to participate in such debates and its obligations concerning time and

[17] Cf. Fundación Microfinanzas del Banco Bilbao Vizcaya Argentaria ("BBVA"), *Código universal de gobierno corporativo para instituciones microfinancieras*, 1st edn (Madrid, March 2011) at *http://www.mfbbva.org/fileadmin/2011/PAGINAS/CODIGO_web.pdf* [Accessed October 2, 2012]; ÍDEM, *Guía para la adopción de principios de buen gobierno en instituciones microfinancieras*, 1st edn (Madrid, March 2011) at *http://www.mfbbva.org/ fileadmin/2011/PAGINAS/GUIA_web.pdf* [Accessed October 2, 2012].

[18] The bulk of managerial fraud in microfinancial banks and other microfunding institutions is related to the absence of independent control organs and risk-monitoring supervisory staff (Fundación Microfinanzas BBVA, *Guía*, pp.13–14).

[19] Cf. the regulatory provisions of the Spanish *Decreto 794/2010, of June 16*, on subventions and aids in the field of international cooperation; and *Real Decreto-Ley 11/2010, July*, containing the regulation of the governance organs and specific aspects of the legal regime of the *Cajas de Ahorro*.

formalities for studying and answering to posed questions and relative data.
- — Sufficient protection of voting rights, which is particularlyimportant in the case of investing minorities—mainly foreign investment—whose knowledge of corporate governance structures might be limited.
- — Transparency on the handling of conflicts of interest among members of the assembly and board members or administrators, and among groups of investors and types of members, especially in case of coexistence of investing and non-investing—and donor-members of the assembly.[20]

- Related to the formal structure of the organ of administration (Board of Directors, executive committee or council)

Operational management and managerial structures—composition and stakeholders of the Board of Directors or governing organ, nomination and compensation system, rules and regulations of managerial bodies, functioning of the Board—, are essential to develop the institutional capacities of the micro-lenders.[21] The following aspects should be taken into detailed consideration:

- Concerning the composition of the organ of administration, there should be enough number of independents and an a timely renewal of all members.
- Managers and directors should have an adequate expertise in banking activity or, if non-financial was the chosen legal form of the microfinancial entity, they should show enough experience in social or third-sector management.
- All managers should reciprocally have access to the relevant information produced by other managers or directors concerning the microfinancial activity and the internal organisational structures. The Secretary of the institution should cooperate to make information accessible within the aforementioned context, and be an experienced jurist or lawyer in the sector.
- Concerning the board or administration committees, a principle of flexibility and efficiency should be implemented. Audit committees should be managed by experienced banking independent auditors so as to effectively check the inner routines in risk monitoring and hedging activity. Specific risk committees would be welcome according to the size, complexity and degree of geographical and personal diversification of microcredit. Governance or ethics committees should be established when corporate social responsibility (CRS) standards are applicable according to bylaw provisions or best sector practice.
- With respect to the functioning of the organ of administration, agendas and sessions should be as flexible and agile as possible, counting on remote or distance facilities as much as possible, in order to facilitate effective democratic participation of represented stakeholders and members in daily management strategic decisions corresponding to the board or executive officers. A principle of dispersion and counterbalance of powers should be recognised, preferably in by-laws or board specific rules and regulations.
- Rules and regulations of the organ of administration should be complemented by specific rules of conduct or ethic codes applicable to officers, executives, managing staff or employees depending on such organ; specific rules of prevention and resolution of personal conflicts of interest should be established in such norms or regulatory provisions.

## Conclusion

The banking-law or company-law regulation and prudential supervision of microlenders and microbanks must be adequate to the specificities of the parties contracting the microcredit. In particular, taking into account the peculiarities of the borrowing microenterprises, considering that microfinance seeks the defense of the individual rights of persons and the improvement of social participation, compromise and solidarity values.[22] In the case of public-sector micro-lenders, public choices and policies may limit the purpose and aim of the microfinancial institution, considering public general macroeconomic or public banking interests.

Adaptation to social needs or prevailing needs of the poorest may bring important banking costs to the financial entities competing in credit markets. However, long-term employment and self-employment generated and the huge potential of social transformation of systems to create

[20] Cf. Fundación Microfinanzas BBVA, *Guía*, 17–20.
[21] Agreeing, M. Jung, S. Lahn and M. Unterberg, *EIF Market studies on micro-lending in the European Union: capacity building and policy recommendations EMN*, March27, 2009, 6–11, 55–84.
[22] See J. M. Fresno, *Propuestas para mejorar la financiación pública del tercer sector de acción social*, Plataforma de ONG de Acción Social, November 16, 2010 at *http://www.donoso.es/wp-content/uploads/personas/propuestas.pdf* [Accessed October 2, 2012].

business opportunities, at least from the EU viewpoint, may be worth the corresponding private and public administrative and financial efforts, including favorable tax schemes and administrative and bureaucratic facilities allowing the microbanks a significant reduction of operating costs.

Although an excess of regulation forestalls the expansion of microfinance, efficient and fair regulation is required to facilitate the universal access to credit, contributing to the generation of new small caps and to the sustainability of the financial system. Within this field, the adaptation of company-law and by-laws of microfinancial institutions to the needs of microenterprises is a must. Otherwise, optimal governance—by means of self regulations as well as through an efficient adaptation of company and banking law to the particularities of microcredit—of these institutions will prevent NGOs, microfinancial intermediaries and entities helping microfinance from public discredit, at once improving deterrence of fraud and mismanagement and fostering public confidence within this hopefully emerging sector in the forthcoming years.