



GOOD PRACTICES - **CASE IDENTIFICATION** /1<sup>ST</sup> LEVEL ANALYSIS

**KIZ SINNOVA Gesellschaft für soziale Innovationen gGmbH**

**1. Good Practice title: "Different" loan decision principles**

The loan decision is based on two principles instead of business plans and/or scoring systems:

I. Is the borrower able AND willing to pay back the loan?

II. Will the personal and business economic situation improve?

Banks have developed sophisticated scoring models to evaluate potential risks. However, these scoring systems do not provide reliable information evaluating start-ups and small businesses. In order to provide loans at competitive interest rates banks are forced to employ automatized and standardized processes. The success of start-ups and small businesses depends largely on entrepreneurial skills and mind-set of the executive managers. Evaluating the personal and economic situation of underserved target groups asks for more information than scoring models can provide. However, loan decisions should be based on indicators that are easy to identify and verify (even by less experienced delivery partners).

**2. Territory of implementation/application (country/region/...)]**

You can collect GPs from outside your region, but make sure that if further information is needed, you can easily get in touch with the GP promoters.

These loan decision principles were implemented and tested across Germany with different delivery partners. KIZ made use of these principles. Delivery partners in different cities across Germany, who were rather inexperienced in microcredit provision, were able to make good decisions, which ensured low default rates, based on these key principles.

**3. Timeframe:**

year of introduction:  year of termination:  (leave 0000 if ongoing)

**4. Brief description of the promoting organization:**

KIZ Finanzkontor is a regional MFI and one of the four founding members of DMI. KIZ has a history of supporting underserved and disadvantaged target groups setting up their own business. To this end KIZ cooperates closely with regional actors from the private and public sector. Due to regulation by



the Microcredit Funds Germany, cross-selling activities were not allowed from 2010 onward. In 2006 KIZ developed a local microfinance programme in close cooperation with the City of Offenbach and other local actors. KIZ used DMI's Trust-based Partnership Model to provide a robust microfinance framework. This local microfinance programme was scaled up to other German Cities such as Leipzig, Nürnberg, Kiel, Duisburg and Gelsenkirchen. The goal was to strengthen the local economy especially in underserved and disadvantaged parts of the cities.

#### **5. Main objective of the initiative:**

Since traditional banking procedures and evaluation of start-ups could not provide a set of reliable loan decision taking principles to ensure low default rates KIZ developed a set of principles based on a different approach. The principles were designed in a way that persons with a non-banking background but some experience supporting entrepreneurs were able to take good loan decisions.

#### **6. Brief explanation of the initiative:**

Briefly present the good practice implemented by the organisation (e.g. specific products & services offered, financial instruments, partnerships developed, technologies and innovations adopted, communications & promotion strategies etc.)

At its core the principles focus on the entrepreneur and his/her personal economic situation rather than formal principles. In order to find answers to questions around willingness and ability to pay back a debt supporting documents like financial statements can be used. Return debit notes are an indicator demonstrating willingness and ability.

The loan application form asks explicitly for other loans and expenses (private and entrepreneurial purposes). With supporting documents like financial statements it is fairly easy to verify the information provided in the loan application. Credit reports can also be used to verify information provided. The assessment of expenses in relation to income provides sufficient information to assess the financial situation of the applicant.

#### **7. Target group and measures to involve the target group:**

Loan officers need a reliable set of tools and guiding principles to assess loan applications efficiently and also ensuring a high level of responsible loan provisioning. On the other hand cost-efficient procedures are required to ensure sustainable microfinance operations.

In order to scale up a microfinance operation without excluding underserved target groups and with limited resources available, any loan decision principles need to be boiled down into only a few (in our case 2 core principles!) rules, which can be easily adapted by less experienced personal.



Additional principles can be applied in cases where a better understanding of the business model is required.

#### **8. Innovativeness:**

Innovative elements of the initiative or other distinctive features compared to other previous programmes.

The innovation is that 2 rather simple principles, which can be easily used by personnel who do not have a banking background and little experience in microcredit provision, can ensure a default rate between 5% and 10% without excluding underserved target groups. The principles do not focus on typical banking procedures (and securities) but on the entrepreneurial skills and personal economic situation of the borrower.

#### **9. Outcomes:**

Please try to find some specific indicators (e.g. number of clients involved, loan disbursed, participants at events...).

Identified success factors of the initiative

The most important outcome is a low default rate since the risk of defaults is the most serious threat for German MFIs. In terms of sustainability MFIs cannot afford to pay for highly skilled and experienced risk managers. Loan officers are now able to make a fair assessment and evaluate the amount of monitoring and crisis intervention, which is rather costly and time consuming, as well as potential risks of default.

Key success factor:

- transparent criteria and principles to assess loans
- standardized procedures to ensure low default rates