

AN ENABLING ENVIRONMENT FOR MICROBUSINESS AND THE RULE OF LAW

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An Enabling Environment for Microbusiness and the Rule of Law

1. What is an enabling legal environment for Microbusiness?
2. How does it relate to Microfinance?
3. How does it relate to the Rule of Law?



1.What is an enabling legal environment?

The Role of UNCITRAL

- Commission requests (2009) Secretariat to study favorable legal framework for microfinance

A/64/17 - Report of the United Nations Commission on International Trade Law, forty-second session (29 June-17 July 2009), para 433 available at:
<http://www.uncitral.org/uncitral/en/commission/sessions/42nd.html>

- Commission agrees (2011) to include microfinance as an item for the future work.

A/66/17 - Report of the United Nations Commission on International Trade Law, forty-fourth session (27 June - 8 July 2011), para. 246 available at:
<http://www.uncitral.org/uncitral/commission/sessions/44th.html>

- Commission (2012) decides to hold colloquium on microfinance and related topics: providing an enabling legal environment for microbusinesses

A/67/17 - Report of the United Nations Commission on International Trade Law, forty-fifth session (25 June-6 July 2012), para. 126 available at:
<http://www.uncitral.org/uncitral/commission/sessions/45th.html>



1.What is an enabling legal environment?

Microfinance Goes Global

- Microfinance evolving from donor-driven NGO-dominated framework towards increasing involvement of international capital markets.
CGAP, Cross-Border Funding for Microfinance (2010), available at
<http://www.cgap.org/publications/cross-border-funding-microfinance>
- 2010, microfinance cross-border funding commitments of \$25 bn.
<http://www.cgap.org/news/international-funding-microfinance-continues-grow>
- Foreign capital investment in microfinance estimated at \$12 bn.
CGAP, Microfinance Investors Adjust Strategy in Tougher Market Conditions (Oct. 2010), available at:
<http://www.cgap.org/publications/microfinance-investors-adjust-strategy-tougher-market-conditions>
- Websites allow peer-to-peer cross-border micro-lending.



1. What is an enabling legal environment for Microbusiness?

The Commission decides (2012) to hold a second colloquium on microfinance

- “with a focus on: **facilitating simplified business incorporation and registration; access to credit** for micro-businesses and small and medium-sized enterprises; **dispute resolution** applicable to microfinance transactions; and **other topics related to creating an enabling legal environment for micro-businesses** and small and medium-sized enterprises.”
- “**a first priority for UNCITRAL**”

A/67/17 - Report of the United Nations Commission on International Trade Law, forty-fifth session (25 June-6 July 2012), para. 126 , available at:
<http://www.uncitral.org/uncitral/commission/sessions/45th.html>

1. What is an enabling legal environment for Microbusiness?

“Doing Business Factors”

- Starting a business
- Constructing Permits
- Electricity
- Registering property
- Getting Credit
- Protecting investors
- Paying taxes
- Trading across borders
- Enforcing contracts
- Resolving Insolvency

IFC Doing Business 2013
Smarter Regulations for Small and Medium Sized Enterprises

1. What is an enabling legal environment for Microbusiness?

Registration

- Legal reforms to empower micro and small borrowers to act as "regular" or "formal" sector borrowers do so by granting them the status of "legal" persons, easily, predictably and inexpensively.
- Legal reforms also enable micro and small borrowers to obtain loans secured **not by** adding to their personal liability or that of their family or friends **but** by pledging their own market valued assets.



1. What is an enabling legal environment for Microbusiness?

Facilitating Migration to Growth Mode

- By regularizing the legal status of micro borrowers and by enabling them to borrow on a secured "line of credit" basis, they can "graduate" from a subsistence form of doing business to a growth mode characteristic of small businesses.

- This migration requires that the micro (heretofore informal) businessman or woman regularize their legal status as business persons or entities.



1. What is an enabling legal environment for Microbusiness?

Access to Credit

- Financial Access 2010 reports that “For firms, especially SMEs, lack of access to finance is often the main obstacle to growth.”
CGAP/World Bank, Financial Access Report 2010 at 1, available at <http://www.cgap.org/sites/default/files/CGAP-Financial-Access-2010.pdf>
- 2011 Colloquium found modern secured lending through use of movable assets and fixtures contributes to the growth of micro businesses by increasing the level of credit and decreasing its cost.
Legal and Regulatory Issues Surrounding Microfinance, UN Doc. A/CN.9/727, paras. 50-51 available at <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V11/818/46/PDF/V1181846.pdf?OpenElement>
- The UNCITRAL Legislative Guide on Secured Transactions would apply to microfinance where collateral is offered as security for the loan and it generally requires that the lender must proceed in good faith and in a commercially reasonable manner.
- But the Guide does not address some of the issues surrounding microfinance such as transparency in loan terms or abusive collection practices.
Id., paras. 33-34.



1. What is an enabling legal environment for Microbusiness?

Data from: Fondo Multilateral de Inversiones, Microfinanzas en América Latina y el Caribe: El Sector en Cifras 2012, Cuadro 4

| COUNTRY | MICROFINANCE RATE (A) | BANK RATE (B) | DIFFERENCE IN RATES (A) – (B) |
|--------------------------------------|-----------------------|---------------|-------------------------------|
| Argentina | 57,2 | 11,4 | 45,8 |
| Bolivia | 17,6 | 9,7 | 7,9 |
| Brazil | n.d. | 21,6 | n.d. |
| Chile | 49,5 | 8,9 | 40,6 |
| Colombia | 22,7 | 10,3 | 12,4 |
| Costa Rica | 23,6 | 11,0 | 12,6 |
| Ecuador | 15,5 | 11,1 | 4,4 |
| El Salvador | 20,0 | 10,8 | 9,2 |
| Guatemala | 30,2 | 13,1 | 17,2 |
| Haití | 55,4 | n.d. | n.d. |
| Honduras | 27,6 | n.d. | n.d. |
| México | 75,8 | 12,4 | 63,4 |
| Nicaragua | 27,9 | 13,4 | 14,5 |
| Panamá | 28,1 | 7,4 | 20,7 |
| Paraguay | 23,5 | n.d. | n.d. |
| Peru | 27,0 | 9,6 | 17,4 |
| Dominican Republic | 25,2 | n.d. | n.d. |
| Uruguay | 35,5 | 7,4 | 28,2 |
| Venezuela | 37,5 | 17,4 | 20,1 |
| Regional Weighted Average (4) | 27,9 | | |

1. What is an enabling legal environment for Microbusiness?

Alternative Dispute Resolution

- An enabling legal environment for microfinance should include a fair, rapid, transparent and inexpensive process for the resolution of disputes.
See Smartcampaign.org (mechanism for complaint resolution seen as top priority in Client Protection Principles), available at: <http://www.smartcampaign.org/about-the-campaign/smart-microfinance-and-the-client-protection-principles>
- 4 billion people lack access to a well-functioning judicial system, let alone in microfinance transactions.
Secretary Note, Selected legal issues impacting microfinance, April 2012, UN Doc. A/CN.9/756, para. 24 citing UNDP, Commission on Legal Empowerment of the Poor, *Making the Law work for Everyone*, available at: www.undp.org/legalempowerment.
- Yet, extrajudicial third-party dispute resolution mechanisms are rarely in place, limiting the effectiveness of any microfinance legal framework for client protection.
- A dispute resolution mechanism for microfinance could be developed that would apply whether or not the loan is secured.
- UNCITRAL has drafted a number of generic legal instruments on arbitration and conciliation but those texts are not tailored for use in the context of solving microfinance disputes.

An Enabling Environment for Microbusiness and the Rule of Law

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2. How does an Enabling legal environment relate to microfinance?

Not limited to Finance

- “As a market-based approach to fighting poverty, **microfinance** is focused on developing entrepreneurship and expanding self-employment”
Legal and regulatory issues surrounding microfinance, Secretariat note, UN doc A/CN.9/727, para. 8, available at <http://www.uncitral.org/uncitral/commission/sessions/44th.html>
- Microfinance understood to relate to the provision of financial services for micro and small businesses.
- The 2011 regional Association of Supervisors of Banks of the Americas [ASBA] Guidelines of Principles For Effective Regulation and Supervision of Microfinance state that microcredit means “**a small loan granted to small business owners** that will be paid back mainly with the cash flow from the business’s sale of goods and services.”
Link in Para 5, Section 2.4.2 of link, available at: http://www.iadb.org/en/news-news-releases/2011-03-23/latin-america-microfinance-regulation_9271.html
- An enabling legal framework extends beyond financial services to cover issues relating to the life cycle of a business: establishment, operation and termination.



2. How does an Enabling legal environment relate to microfinance?

Not limited to Micro

- Drawing distinction between microbusiness and small enterprises not practicable for purposes of enabling legal environment.
- Definitions vary substantially and may be based on number of employees, sales volume, or loan size.
- “Often, definition relies on multiple criteria and depends on the industry.”



CGAP/World Bank, Financial Access Report 2010 at 37; BCBS, Microfinance activities and the Core Principles for Effective Banking Supervision, at 1, 34-35

2. How does an Enabling legal environment relate to microfinance?

Not limited to Micro

- Philippines regulations: “the maximum principle amount of microfinance loans shall not exceed PHP 150,000” (approximately \$3700).
Philippines Circular No. 272 Microfinance Operations, available at:
<http://www.bu.edu/bucfip/files/2012/01/Circular-No.-272-microfinance-operations.pdf>
- Russian law: "microloan meaning a loan . . . not exceeding one million roubles"(approximately \$33,000).
Russia Federal Law No. 151-FZ of July 2, 2010, Art. 12, para. 8, available at:
<http://www.bu.edu/bucfip/files/2012/01/Federal-Law-No.-151-FZ-of-2010-on-Microfinance-and-Microfinance-Organisations-English.pdf>
- USAID defines a “microenterprise” to mean:
“A very small enterprise owned and operated by poor people, usually in the informal sector. . . . the term is restricted to enterprises with **10 or fewer workers**, including the micro entrepreneur and any unpaid family workers.”
See Microenterprise Results Reporting: Methodology and Statistical Annexes FY 2010 19, U.S. AID available at:
http://transition.usaid.gov/our_work/economic_growth_and_trade/micro/index.html

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3. How does an Enabling legal environment relate to Rule of Law?

- Microfinance often seen as serving primarily unregulated informal/extralegal sector.
- Unregulated informal extra-legal sector may:
 - be subject to abuse by those with power
 - limit the range of activities business can engage in given limited capabilities to diversify
 - encourage micro businesses to follow “low road” practices of sector
 - precipitate decline in wages and worsening of working conditions (through *inter alia* failure to comply with local labor laws)
 - when microenterprise fails (and majority will), microloan may have to be repaid by sources of income unrelated to original microloan/selling long-held family assets.



See Milford Bateman & Ha-Joon Chang, *The Microfinance Illusion* 23 (March 2009) (unpublished manuscript), available at: <http://www.econ.cam.ac.uk/faculty/chang/pubs/Microfinance.pdf>

3. How does an Enabling legal environment relate to Rule of Law?

- Recent GA Declaration on the Rule of Law stresses that the rule of law and development are mutually reinforcing.

GA Resolution 67/1, Declaration of the High-level Meeting of the General Assembly on the Rule of Law at the National and International Levels, available at:
http://unrol.org/files/Declaration%20HLM_A%20RES%2067%201.pdf



- Conference recognizes importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment and facilitating entrepreneurship and investment.
- UNCITRAL commended in modernizing and harmonizing international trade law.

Conclusion

- UNCITRAL should establish a Working Group on microfinance and related topics.
- UNCITRAL should focus initially on those matters relating to microfinance where it has the greatest experience and where its work would complement the activities of other organizations involved in the field.
- Creation of an Enabling Legal Environment:
 - Potential to Invigorate microfinance
 - Provide micro and small enterprises opportunity to compete and flourish
 - Build capacity for economic growth and improve trade
 - Protect against unfair or deceptive practices
 - Extend real access to Justice for all.

