



Microcredit & Microfinance in Italy

An international case study

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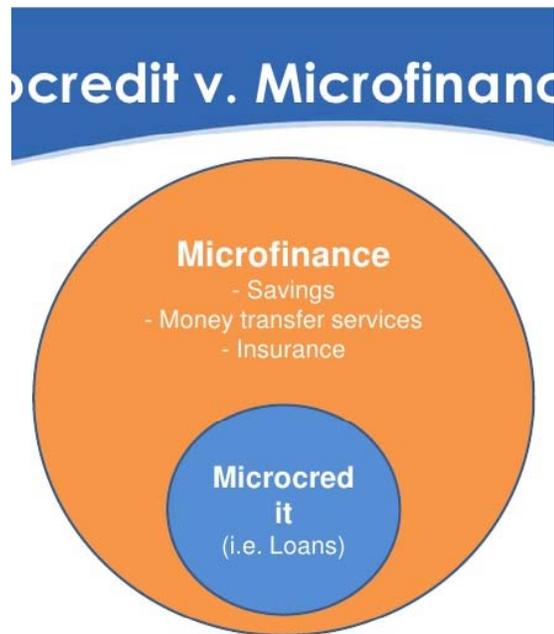
What is Microcredit?

« The extension of small loans to low-income clients who traditionally lack access to banking»

It is normally characterized as making small loans available directly to small-scale entrepreneurs to enable them either to establish or to expand micro-enterprises and small businesses.

Microcredit is normally **applied to target groups** that would otherwise not qualify for loans from formal institutions.

Microcredit vs. Microfinance



- ▶ Definition of Microcredit: is the **small credit facility** provided to the needy people whose earning capacity is very poor.

The loan is provided to the borrowers who are **unemployed**, lacking collateral and whose credit history is not sound. The loan is mainly granted to help people **earn their livelihood**, especially, **women** who can start their business and become independent.

Microcredit not only **increases the income level of the poor people but also raise their living standard**. It provides the financial assistance to the extreme poor class of people in **rural** areas to help them become self-employed rather than depending on loan sharks for raising finance who charge exorbitant interest rates.

The best thing about microcredit is that the **loan does not require any asset** as collateral. The **loan is granted for a short period only**.

- ▶ Definition of Microfinance: is a broad spectrum of financial services provided to the people of low-income groups who cannot take bank's assistance banking and allied services.

The service is available to **extremely poor people**, no matter where they live. The purpose of microfinance is to raise the earnings of low-class people and let them access to deposits and loans.

The clients may include **women, farmers, pensioners** and so on. Microfinance plays a revolutionary role in any country's economy. It helps the poor people to **fulfill their basic needs and safeguard them from any risks**. It raises the per capita income.

It encourages women empowerment by providing term economic assistance and hence advocates gender equality.

Microfinance institutions not only provides **capital to the startups** or small businessman but also **deliver** such **financial services** to the poor people who are constantly avoided by the formal financial sector.

Different type of borrowers

3 *types of borrowers*: each one have different types of liabilities and the bank/institute that lend them have different types of risk /expectations to get their money back and different interest rates.

- ▶ **group lending**, the most **common way that microcredit borrowers can have access to loans**. The group lending programs are **groups of customers** that are self-formed and they have a jointly liability to repay the loan that was given to the group members. If one member fails to repay the loan, then the other members have to contribute. It is normally formed by **people living close to each other** and creates high incentives for the individual members to monitor the rest of the group. A leader in the group is very helpful to make sure that everyone will repay their part of the loan and keep monitoring their activities to make sure that they will repay.
- ▶ **Individual ones**, they have **two-sided relationship** with the institute as normal lenders do. The liability for repaying the loan stands along with the individual borrower only. In other cases that the borrower owns a small **land** it might be used as collateral. The monitoring cost is high but studies in Bangladesh sawn that **individual lenders have the highest average profit for the bank**.
- ▶ **Village banks**. They are **kind of a branch of the bank**, they form a large group and has a degree of self-governance. Sometimes village bank can be held:
 - ❑ by an individual that is wealthier than the others so he can borrow from the institute and then lend the amounts to the rest of the people.
 - ❑ Majority of the customers of village banks are women and also the amounts that village bank lend are small.

System of Guarantees

Due to the *absence of appropriate collateral guaranties*, the microcredit providers adopt different strategies to attain the engagement of Mc recipients for repaying their debts. The providers select the potential beneficiaries of microcredit deeply analyzing their *moral status*, their *professional skills* and the *potentials* of their business ideas. Microcredit brings the concept of credit back to its first meaning, that is "to *give faith*". There are different categories of warranties for microcredit:

- ▶ **Personal warranties**, in which one or more subjects (family members, friends, colleagues or professional players) repay the loan if the debtor is insolvent (Isaia, 2007). The surety is an example of personal warranty;
- ▶ **Accessory warranties**, that are assets with a low economic value but a high notional value for the debtor, that will engage deeply to repay his debt and consequently to keep the ownership on these assets. The accessory warranties can be **objects** related to the work of the debtor (for example, a truck for a carrier or a plough for a farmer) or ones with a relevant **sentimental value** for him (ceramics, a watch, jewellery, a wedding dress, etc.) (Becchetti, 2008).

Pro

*No one can deny that micro-credit is **beneficial** for the participants and also for the non-financial active people. Many can argue that it might not be available for everyone but even so the overall effects are positive for all. In Bangladesh, it was found (Khandker, 2005) that microcredit had:*

- ▶ A large positive impact on the welfare of the households that used this type of borrowing and **consumption was raised** among the participants.
- ▶ There was a **spill over effect** that was helping even the non-participants to have some benefits.
- ▶ Because the borrowing households were able to perform better in their businesses, they were **upgrading their living facilities to higher standards**, proper shower, better bathroom fixtures and even plan to send their children to school or college.

Other comparative Benefits of Microcredit

Inclusion of the poor into the financial system.

Access to loans can open up different new opportunities such as starting a business, improving housing conditions, or purchasing an asset.

Lower interest rates compared to local moneylenders.

Dignity and self respect of employment.

Goes beyond the traditional concept of development aid as a "handout".

Opportunity for education and community development.

Cons and drawbacks

- ▶ Raising of interest rates of the loans due to the economic **crisis** and **reduction of funds** available **from the government subsidies or donations**. If though we use loan size as a proxy of poverty, then we will find out that the larger loans are not applicable for the group borrowers and it has to be a less poor borrower that is interested in investing in larger businesses.
- ▶ In search of cost-effectiveness institutes want to increase their loan size and that means that they have to focus on **clients that seek larger size loans**. The existing clients get slowly less poor than the originally where so the institutes now seem to lend wealthier clients that the ones they started with and they were devoted to. This means that **institutes might shift focus to wealthier clients and that will affect the outreach to the poorest** that are those ones that originally microcredit institutes made for.
- ▶ Not meeting arrangements with the groups organized by the institutes. In some cases, those meetings helped very much to have the **group focused** and achieve greater wealth improvement than if they did not have the guidelines, as well as if there are constrains on the **contract about how the money have to be distribute** among business investment and self-purchases.
- ▶ The increased bureaucracy in the loan administration that increases the **cost** as well as the **time that a loan needs to be approved**.

The Italian way for microcredit: a brief history

In Italy, there is a **strong movement against usury** that contributes to the development of personal microcredits.

Banks are becoming more interested in microfinance at the national and local level and are starting to enter into local partnerships. **Public bodies** are also progressively increasing their action in this sector, but still in a limited way.

The microfinance sector is thus **still fragmented**, with some very dynamic institutions which are aiming at strong growth and real sustainability.

At the end of the 1960s, the **mutual guarantee system Confidi** was created: not-for-profit bodies act as guarantors for credits supplied by banking institutions to their members, generally small and medium-sized enterprises (SMEs). Furthermore, in the 1970s, the creation of the MAGs (Mutuo di AutoGestione), "self-managed" mutual benefit societies providing credits, advice and training, was an important step in the fight against banking exclusion.

Having turned into cooperatives, they set up, in 1994, jointly with other non-profit bodies, **Banca Popolare Etica**, an alternative to the traditional banking system.

Today, microfinance sector gets more and more structured, especially since the creation in 2008 of **RITMI, the Italian microfinance network**. This network brings together Italian microcredit institutions and strives to coordinate and facilitate the development of microcredit through **good practices sharing and knowledge sharing**.

As regards the Italian government, in the last years, it has tried to facilitate enterprise creation, among which microenterprises, through simplified procedures and supporting taxes' processes (legal decree April 2000, and Decree Bersari July 2007).

In addition, it created in 2000 the microcredit programme "Incentives for self-entrepreneurship and self-employment" together with, in 2007, a **fund supporting workers in precarious situations**, women and young entrepreneurs. Further, in December 2007, the state implemented the **Permanent Committee for Microcredit**, however essentially looking at the international sphere.

The Italian way for microcredit: the activity today

- ▶ In Italy, **82% of microfinance institutions are not-for-profit.**
- ▶ Three types of non-banking institutions grant microcredits: **Cooperatives or consortiums**, which **collect funds and invest** them, and serve as a **guarantee fund for the loans granted** by banks. The loans can cover very different needs (housing, child care, projects proposed by unemployed persons). These cooperatives play an important social role.
- ▶ Microcredit requirements differ from one **region to another**, and are much more important in the South of the peninsula.
- ▶ The **beneficiaries** of microcredits are new small firms (start-ups) and micro-companies of **less than five employees**, as well as women and immigrants. On average, 27% of the credits granted are provided to women, 21% to immigrant populations and 11% to young people. It is also necessary to underline that the Italian Caritas is very active in personal **social loans to excluded persons.**
- ▶ According to the available data, the value of loans granted in 2009 amounted to **10,9 million Euro for 1909 business loans.** The **average amount was 5000 Euro.** Nevertheless, the activity overall is difficult to define, taking into account the explosion of the sector and the lack of a common approach to and definition of microcredit.
- ▶ The microfinance sector in Italy is nevertheless in a phase of steady development.



The Italian way for Microcredit: a new legal framework

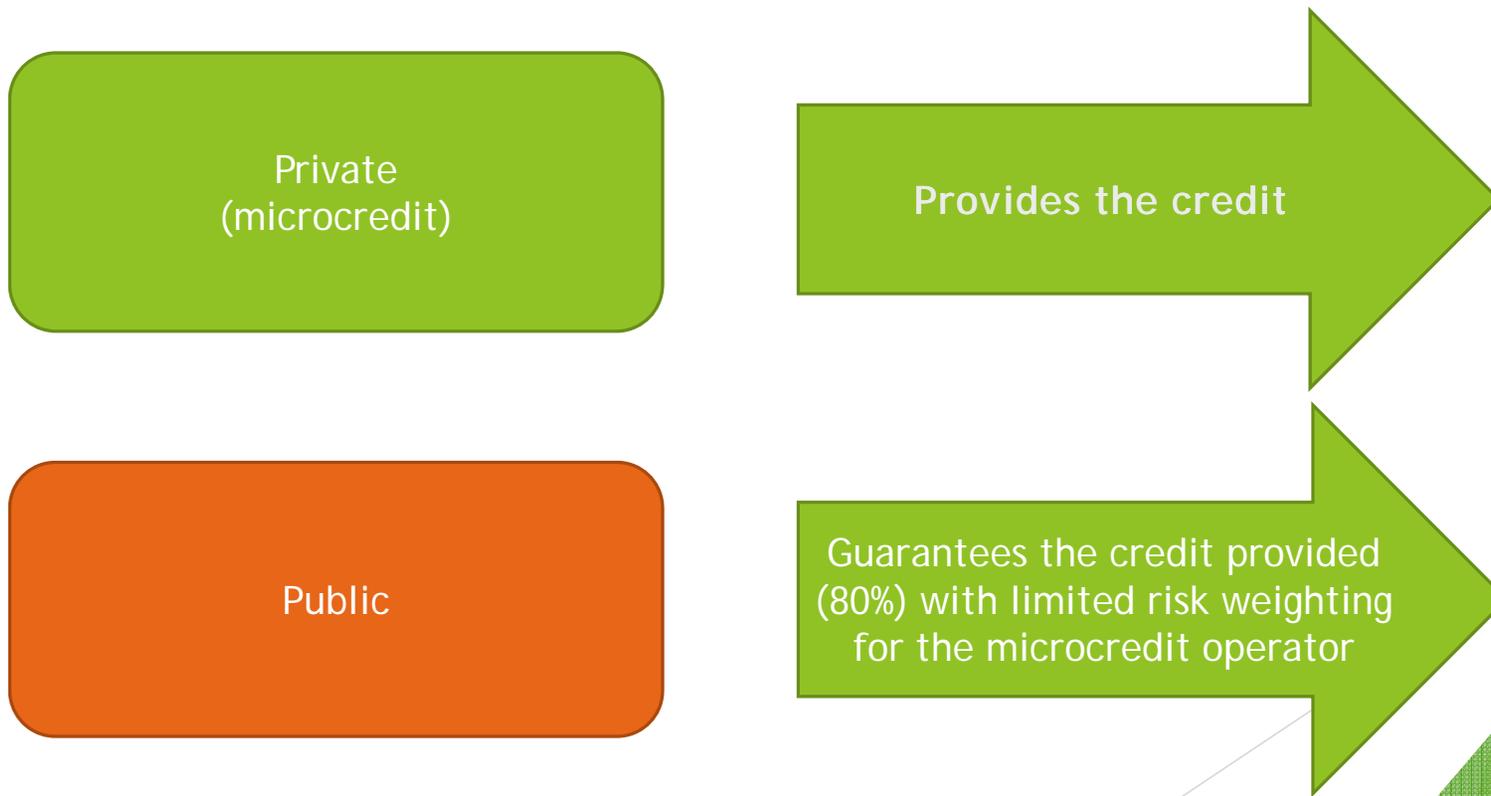
- ▶ 2010: The Italian bank system reform (Legislative Decree 141/2010) has identified a **new category of intermediaries**, known as **Microcredit Operators**, which, when certain requirements are met, may ask to be entered in a **register held by the Bank of Italy**.
- ▶ 2014: Ministerial Decree **176/2014** defines a) the **technical characteristics** of loans, b) the **purposes** and the corresponding beneficiaries for each type of microcredit loan as well as c) the **requirements for operators to be entered in the register** held by the Bank of Italy.
- ▶ 2015: Bank of Italy Regulation **defined the procedure to join the Microcredit operators register**.



The Italian way for Microcredit: a new legal framework

- ▶ **Entrepreneurial microcredit:** aimed to the **start-up** and development of microenterprise or self-employment business initiatives:
 - set-up by **less than 5 years**;
 - max EUR 100.000 turnover;
 - max EUR 300.000 total assets.
- ▶ **Maximum amount loan: EUR 25.000**
- ▶ **Compulsory Business Development Services:** fundamental component of microcredit operations - **technical assistance, tutoring and monitoring**.

The Italian way for Microcredit: a new legal framework



General scheme of public intervention

*Currently, in most cases the programs of microcredit are fostered or conducted by **participation of public subjects**. Most of these programmes follow a "quadrangular intervention scheme" (Andreoni, Sassatelli, Vichi, 2013), where four different categories of players are present:*

- ▶ Public bodies, that **procure the financial resources**
 - ❖ to supply microcredit
 - ❖ and/or to found a guarantee fund for insuring those who provide effectively the loans;
- ▶ Qualified operators, that **select** the potential beneficiaries;
- ▶ Banks, that supply effectively the **loans**;
- ▶ Social operators- in most cases subjects belonging to no-profit sector (NGOs) - that **support** the beneficiaries of a microcredit **before and during** the repaying period of each loan.

Microcredit in Italy: some data

Considering data until 31th December 2012:

- 172 operational programmes of microcredit;
- 29 of them started in 2012;
- programmes have financed 12,418 beneficiaries
- supplying €115,900,000

Public & Private financing

Private sector have financed 53 projects for an amount of 43 million tent:

- private operators have provided microcredit to 4,048 beneficiaries
- Banks have provided microcredit for 2,914 entities
- Religious bodies have provided microcredit for 2,612 beneficiaries

Public bodies have financed 51 projects for an amount of 39 million tent:

- public bodies have provided loans to 2,844

Mc beneficiaries

Categories of Mc beneficiaries

- ▶ Natural persons have received 64 million.
- ▶ Legal persons have received 8,75 million.
- ▶ Programs founding both legal and natural persons, have received 40 million.

In Italy, the group lending appeared secondary because only about €3 million out of €113 have financed businesses of people joined in repaying groups of two or more units.

Data analysis

the most common profile of a Mc beneficiary seems to be a **single person who applies for a loan of an amount less than €5,000** to overcome financial difficulties related to his/her household

according to the National Agency for Microcredit, it has supported the creation of nearly 20,000 jobs in Italy between 2011 and 2013

Conclusions

1

The literature confirms that microcredit can **improve the financial sustainability of large number of persons**, unable to access credit otherwise

2

The supply of microcredit **on a large scale** can produce both positive and negative results; the correct implementation of Mc programmes allows to maximize their effectiveness.

3

A necessary condition to accomplish this goal is that policy makers and the Mc stakeholders succeed in **establishing regulations, actions and measures to build a suitable network** for supporting both the creation of new start-ups and new employment, and the supply of microcredit within a specific socioeconomic context.