Can microfinance regulation encourage mission drift? The Italian case

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ABSTRACT

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Achieving both financial and social objectives has proved challenging for microfinance institutions (MFIs) operating in Europe. The European Union has traditionally played a role in supporting the social mission of many MFIs through favourable policies and financial support. However, differences in the microfinance regulatory environments in each of the European countries have contributed to cross-country variations in the sector's evolution. However, the academic literature on this topic is scarce. Frequently, European MFIs have overcome regulation constraints by establishing partnerships with commercial banks. These partnerships are mostly intended to improve double bottom line management and achieve both financial and social objectives; however, these alliances can be hindered by regulatory changes. This paper aims to explore whether the introduction of microfinance regulation might affect the way in which MFIs manage their double bottom line. Given the recent passage of a microfinance law in Italy, we qualitatively explore the perceptions of a group of Italian microfinance stakeholders on the new regulatory framework and its effect on MFIs' double bottom line management through establishing interinstitutional partnerships. Focusing on one of the regions with more microcredit programmes in Italy (Emilia Romagna), we generated data through qualitative in-depth semi-structured interviews with five senior managers in MFIs, two members of the Italian government who voted for the new microfinance law and one expert in the field of microcredit. Additionally, secondary data were collected for triangulation. The perceived effects of the new regulation on MFIs' strategical partnerships and mission drift are relevant for microfinance practitioners, regulators and policymakers. Despite emerging as an attempt of market correction, regulation is perceived to undermine the ways in which MFIs can reach financially excluded individuals. These conclusions need to be taken into account to prevent unintended effects on the microfinance sector and its outreach. Although non-generalisable, the emergent saturated findings also lead to questions for academics and lay the groundwork for further longitudinal research.

KEYWORDS

Microfinance; regulation; mission-drift; Italy

1. INTRODUCTION

The social aspirations of most European microfinance institutions (MFIs) are frequently put at risk by their limited market viability, which is constrained by their scope and scale (Balkenhol, 2015). Since 2007, the European Union has tried to preserve the social mission and objectives of European MFIs through favourable policies and financial support (Lorenzi, 2016). However, the differences in the regulatory environments in each country, with their unintended consequences on the sector, have contributed to cross-country differences in the sector's evolution and management of its double bottom line to achieve dual objectives.

Concerns have been raised about the ability of European MFIs to cope with the lack of specific regulation or existing regulatory adaptations of the mainstream financial rules to microfinance (MFC-EMN, 2016). Frequently, MFIs in the region have partnered with commercial banks as a strategy to fulfil both their social and financial objectives, overcoming in this way regulatory constraints (Cozarenco, 2015). However, in some European contexts such as the French, specific legal restrictions impose a model of partnership and alliances that can affect the achievement of the social objectives of the MFIs (Cozarenco and Szafarz, 2015). Although the performance of European MFIs is well analysed in the literature (Botti and Corsi, 2011), it has not been linked to the most recent regulatory interventions in the European microfinance sector.

This paper contributes to the academic debate on the effects of microfinance regulation on double bottom line management of MFIs. We qualitatively explore the perceptions of MFIs' senior managers and other microfinance stakeholders in Italy, where a microfinance law was passed and implemented in 2014. The paper is structured as follows. In Section 2 we describe the theoretical background. Section 3 details the methodology. The findings are presented in Section 4 and the conclusion and policy recommendations are described in Section 5.

2. LITERATURE REVIEW

Regulation can be defined as a process whereby different institutional stakeholders, including regulators, respond to an outcome-based set of rules (Balleisen and Moss, 2010). In recent years, increasing attention has been devoted by scholars to the influence that stakeholders have on the sustainability and performance of MFIs (Hudon, 2008). In this line, regulation and supervision of the microfinance sector has also attracted academic interest.

Microfinance has been considered effective when market distortions, systemic risks and consumers' exploitation are prevented by governments' regulatory and supervisory action (Ahmed et al., 2013). This has been particularly discussed in the literature in relation to deposit services provided by MFIs and the systemic risk that this practice can represent in certain transitional economies (Arun, 2005). On the other hand, compared to large financial institutions such as banks, small and sometimes highly risky MFIs have often been considered not capable of absorbing the costs of regulation and supervision, which puts at risk the sustainability of the sector as a whole. Hence, depending on whether and how it is implemented, regulation has been considered by scholars as a driving force that may affect MFI's governance, size, management practices, accountability and rating, which can all in turn affect social and financial outcomes of the microlending operations as well as microborrowers' indebtedness levels and repayment capacity (Hartarska, 2005; Ayayi and Sene, 2010; Schicks, 2014; Morvant-Roux, 2015).

The effects of regulation on microfinance have been mainly explored in developing contexts where empirical studies have mostly focused on the responses of the sector to prudential

regulatory frameworks and examined the regulation effects against MFIs' indicators of social and financial performance. Regulation has been considered a powerful instrument to boost the sustainability and efficiency of the microfinance sector, since it enables competition and, therefore, increases the numbers of MFIs' clients (Hartarska and Nadolnyak, 2007). However, it has equally been suggested that regulation does not affect the sustainability and profitability of the MFIs (Hartarska, 2009; Cull et al., 2011; Pati, 2012), nor its outreach levels (Mersland and Strøm, 2009).

Other scholars, mostly through qualitative analysis, have aimed to further understand the limits to supervise and regulate of governments in developing country contexts. These limits have been explored in the context of how regulation of MFIs might affect efficiency and corporate governance. For example, research has focused on the effects of prudential regulation and supervision on prospects of growth and efficiency of MFIs in Ghana (Anku-Stede, 2014) and on corporate governance in Nigeria and Zambia (Okoye and Siwale, 2017). Finally, other scholars have analysed the need for supplementary regulatory mechanisms, other than self-regulation of MFIs, to protect microfinance clients from over-indebtedness in competitive contexts (Afonso et al., 2016).

From a European perspective, the literature exploring the effects of regulation on MFIs' operations is limited. Dayson and Vik (2014) suggest that the microfinance sector in Europe will not be efficient until specific standards are properly designed. With reference to the European Code of Conduct for Microcredit Provision, the authors state that "a strong externally regulated code can minimize the political pressure for regulation and help drive up performance standards" (Dayson and Vik, 2014). On the contrary, Pedrini et al. (2016) propose tailored legal requirements for the MFIs; more flexible standards and interest rate limits than those applied to banks would diversify the microcredit offer, avoid subsidisation of MFIs and encourage banks to downscale their activities. European MFIs have traditionally overcome the lack of specific regulation by developing partnerships with banks. According to Cozarenco (2015), these partnerships are mainly implemented to "sidestepping [banking] regulatory constraints and high costs of implementation" of microcredit programmes or to overcome the absence of legal recognition of microfinance that impedes MFIs to operate directly in the microcredit chain. These partnerships, triggered by regulatory environments, have been shown to have unintended and detrimental consequences on gender gaps (Cozarenco and Szafarz, 2015; Brana, 2011). At the same time, the lack of regulation of the microfinance sector in Spain has been thought to undermine the effective development of financial inclusion programmes (Estapé-Dubreuil and Torreguitart-Mirada, 2013).

To our knowledge, the effects on the performance of European MFIs when introducing a regulatory framework specifically designed for microfinance and financial intermediaries has not been explored in the literature. In this paper, we explore the subjective perceptions of different stakeholders on how MFIs manage their double bottom line in the context of the new microfinance regulation in Italy in 2014.

3. DATA AND METHODOLOGY

3.1 Microfinance regulation in Italy: the Emilia Romagna region

In 2014, the Italian Government approved new microfinance legislation that distinguishes between entrepreneurial and social microcredit. In this regulatory framework, entrepreneurial microcredit is defined as microloans of up to 25,000 Euros (35,000 Euros in specific cases) for microentrepreneurs and social microcredit as loans of up to 10,000 Euros for social inclusion.

The new regulation also introduces specialised microcredit operators (MOs) and sets up specific standards that MFIs need to comply with to be regulated as such. To fully operate in the microcredit sector after the passage of the law, non-profit organisations (NPOs) were required to adjust their capital adequacy, legal status (e.g. Plc, Ltd, Cooperative limited-liability company), products (provide at least 51% of the microloans to micro-enterprises), services (two compulsory credit-plus services), governance, target and interest rate limits (MEF, 2014). NPOs not able to adapt to the new standards were limited to disbursing social microcredit at a capped interest rate, which exclusively covers operational expenses and costs of credit-plus services (**Table 1**).

Furthermore, due to implementation of a parallel regulation on financial intermediaries, small-scale socially-oriented Non-Bank Financial Institutions (NBFIs) operating in the microcredit sector were also required to adequate their Risk-Weighted Assets (RWA at 6%) and capital and, therefore, had to start operating under the supervision of the Bank of Italy (2016). Along with the new microcredit legislation, the Italian Government promoted Microcredit Guarantees Schemes (Leone and Porretta, 2014), which provide insurance to MOs, banks and NBFIs screen against default risks of microentrepreneurs by covering up to 80% of the defaulted loan.

Table 1 *Overview of the Italian microcredit legislation*

	Legal form	Products and beneficiaries	Requirements
MO	Plc; Ltd; Cooperative limited (liability) company; Publicly traded partnership company	**1) Entrepreneurial microcredit:** At least 51% of the total loan portfolio - Up to 25,000 Euros (max. 7 years). - Up to 35,000 Euros (max 10 years; the borrower has paid off the last six instalments and the project development has achieved expected results). - Microenterprises (financial leverage < 100,000 Euros) and Self-employed individuals within their first five years of activity. **2) Social microcredit:** - Maximum 49% of the total loan portfolio - Up to 10,000 Euros with no collaterals for max. 5 years. - Individuals who are experiencing economic or social vulnerability (e.g. unemployment; poor standard living conditions)	• Registration in the microcredit operators list • Capital adequacy: 250,000 Euros • Interest rates on an average basis of interests charged on loans by banks multiplied by 0.8. • At least two different credit-plus services • Explicit social mission and business and microcredit project plans (including credit models, targets, monitoring processes and partnerships for credit-plus services provision). • Integrity requirements for shareholders owning more than 10% of the share capital. • Professional and integrity requirements for managers and directors of the MFIs.
NPO	Association; Foundation Mutual aid society; Local and governmental agency; Social cooperative; Non-profit cooperative	**Social microcredit** • Up to 10,000 Euros with no collaterals for max. 5 years. • Individuals who are experiencing economic or social vulnerability and: (i) are unemployed or in forced reduction of working hours and/or (ii) cannot provide standard living conditions to themselves and their households.	• Interest rates on an average basis of interests charged on loans by banks multiplied by 0.4. • Exclusive social mission and business activities related to social microcredit • Integrity requirements for shareholders owning more than 10% of the share capital. • Professional and integrity requirements for managers and directors of the MFIs.

The region in North Italy where this study is focused, Emilia Romagna, is particularly interesting. In the period 2005-2013, North Italy concentrated the highest number of microcredit initiatives and microloans disbursed (ENM, 2014). Moreover, North Italy has also seen an increase of

funds for microenterprise, as well as a stronger role of banks in the provision of microloans and higher percentages of loans over 25,000 Euros (ENM, 2014).

Emilia-Romagna holds the second highest number of loans disbursed and lowest value of average loan size according to the number of active programmes in the region, thus suggesting a higher intensity of microcredit operations (**Table 2**). It also hosts to date the highest percentage of immigrants (per inhabitant) in Italy (REM, 2015) – generally considered as microcredit target for both small trading and business activities and financial inclusion (EC, 2014) – and has registered the second highest number of enterprises per thousand of inhabitants in North Italy, among which microenterprises represent a possible target for MFIs (Istat, 2013). In summary, Emilia Romagna has been said to reflect the Italian microcredit tendencies (Brunori et al. 2014).

Table 2 *Overview of the Italian microcredit sector by region, number of programmes, number of loans, Euros disbursed and average loan size 2005-2013 (ENM, 2014)*

Areas and regions	No. of programmes	No. of loans	Euros disbursed (million)	Average loan Size
North Italy	**111**	**20,492**	**129,1**	**6,300**
Emilia Romagna	23	3,733	10,0	2,684
Friuli Venezia Giulia	8	513	0,9	1,846
Liguria	4	3,393	20,0	5,896
Lombardia	32	3,348	27,6	8,239
Piemonte	20	5,003	53,1	10,611
Trentino Alto Adige	3	337	0,9	2,535
Valle d'Aosta	2	291	1,1	3,751
Veneto	19	3,874	15,5	4,007
Central Italy	**65**	**15,700**	**201,1**	**12,809**
Lazio	16	5,298	55,4	10,457
Marche	9	1,855	27,1	14,629
Toscana	34	8,096	113,4	14,011
Umbria	6	451	5,1	11,387
South Italy	**97**	**15,290**	**277,7**	**18,160**
Abruzzo	11	2,123	36,3	17,111
Basilicata	9	1,386	17,7	12,775
Calabria	17	4,435	103,1	23,247
Campania	14	1,595	32,4	20,300
Molise	7	303	4,3	14,342
Puglia	16	806	11,8	14,589
Sardegna	6	2,937	59,4	20,232
Sicilia	17	1,705	12,6	7,413
Cross-region	**24**	**33,921**	**299,1**	**8,817**
Total	**297**	**85,403**	**907,0**	**10,620**

3.2 Sample and methods

Our study presents a case-study constructed through a three-tiered purposive sampling strategy: extreme and intensity case sampling and maximum variation sampling techniques. The first two techniques have been described as effective to provide enlightening cases and respectively synthetise notable success/failure of actions and rich examples of the phenomenon under investigation, while the third one may help the researcher to offer a more holistic approach to the appraisal of the phenomenon under research (Patton, 2015). In practical terms, extreme or deviant case sampling was employed to select Italy as irregular case of regulated European microfinance (Cozarenco, 2015), with specific governmental development measures (Microcredit Guarantees) to facilitate micro-entrepreneurs to access sources of funding (Leone and Porretta, 2014). Intensity sampling has led to choose Emilia-Romagna for its high number of microcredit programmes and initiatives ran until 2013 and the diversity of MFIs operating in the region.

Maximum variation sampling was finally employed to generate qualitative data from in-depth semi-structured interviews with eight diverse microfinance stakeholders detailed in **Table 3**. A secondary data collection process was also undertaken, aimed at data triangulation between primary and secondary sources of information (Denzin, 2009).

Table 3 *Respondents, data typology and source*

PRIMARY DATA - Interviews		**SECONDARY DATA**	
Organisation/ Institution	**Respondent**	**Type of data**	**Organisational profile**
PerMicro – NBFI. Prudentially regulated limited financial company.	Branch manager of PerMicro Bologna	Institutional rating and social report retrieved from website[1].	The largest financial intermediary in Italy specialised in microcredit and operating at national level since 2007. PerMicro offers mainly individual microloans to immigrants, but also entrepreneurial microcredit to a wide range of clients. PerMicro takes part in the European Commission programme EaSI.
Credito per l'Italia (CxIT) – NBFI. Prudentially regulated social enterprise.	Microcredit Project Manager	Social report retrieved from website.	Operating since 2011 in earthquake-hit regions of Italy CxIT is mainly specialised in providing microcredit guarantees and credit plus activities in partnership with cooperative banks and third sector organisations. CxIT has started to operate as direct provider of microfinance.
EmilBanca – Cooperative Bank	Microcredit Project Manager for entrepreneurial activities Microcredit Project Manager for social microcredit	Service information and social report from website.	The first bank to have applied for social rating. It offers both social and entrepreneurial microcredit. EmilBanca has a high territorial coverage in Emilia Romagna (46 branches). Partner of the European programme Progress Microfinance.
Mag6 –Mutual Self Managing Cooperative (Mag) operating and regulated as MO.	Microcredit Project Manager - Emilia Romagna	Service and institutional information from website and respondent.	Operating as cooperative and engaged in financial activities based on the principle of ethics and solidarity. Cooperative members' savings are collected as shares of capital and used to disburse loans to other members. Loans are intended for business activities of social cooperatives and social enterprises, but also for members with financial problems and women who experienced domestic violence. Mag6 is now a MO.
Grameen Italian (Bologna) – Research Foundation	Research and microcredit expert	-	Extensive experience on microfinance projects.
Italian Government	Parliament Member Parliament Member	Microcredit legislation texts (2010-2014).	Voted for the new microcredit legislation

The data were collected between June and December 2016, after the passage and implementation of the law, and were organised according to the source of information (interviews or secondary data) and the typology of the texts (Yin, 2014). Interviews lasted between 50 and 90 minutes and were conducted in Italian. All the relevant texts, including full

[1] PerMicro's institutional rating was conducted by Microfinanza Rating in April 2016.

transcriptions of interviews and open-source documents have been processed through a structural coding (Saldana, 2013), so as to generate initial codes across multi-respondents' data and collate them to each code (Vaismoradi et al., 2013) using QSR NVivo 10. Looking for emerging themes (thematic analysis) from the collation of data to codes has constituted the following phase of the analytic process, which has been guided also through the revision of the topics highlighted in the literature review (Arksey and Knight, 1999). The diversified nature of stakeholders involved in the research, and the lack of new emerging themes from the interviews and secondary data analysis led to data saturation (Yin, 2014).

4. FINDINGS

4.1. Microfinance partnerships for double bottom line management

The relevance of partnerships and collaborations established between different actors in the Italian microfinance scene (MOs, NBFIs, commercial banks, financial cooperatives and implementers of public programmes) emerged as crucial to how microcredit providers manage more effectively and efficiently their double bottom lines. Different types of partnerships were identified in our analysis. Firstly, partnerships were observed between microcredit providers and commercial (high street) banks and financial cooperatives. Secondly, alliances between MFIs and charities were also frequent. Thirdly, collaborations were established between MFIs and local authorities implementing social policy. Finally, the microcredit sector has strong links with the Italian Government through the public Microcredit Guarantees programme which provides direct credit guarantees and has the Government acting as a guarantor of last resort. Frequently, a MFI would have partnerships with more than one of these organisations.

These diverse partnerships and collaborations were established with different specific aims. However, all of these aims were oriented to simultaneously attain both financial and social objectives. In general, the aims of these partnerships were (a) to increase the scale of operations to reach more vulnerable clients and (b) improved risk management strategies.

Partnerships to increase breadth and depth of outreach

The scale of microcredit initiatives (breadth of outreach) was identified as crucial to the sustainability of microcredit programmes. In this respect, institutional partnerships emerged to be the main strategies to increase the number of microloans disbursed. Interviewees acknowledged that MFIs sharing front/back-offices and services with larger credit institutions, co-funding projects with banking groups and networking with more diverse institutions represented chances to reach more potential consumers and enhance proximity between MFI and clients. As one of our interviewees puts it when talking about partnering with commercial banks:

> *Financial institutions or microcredit operators have to find a way to increase their number of loans … [Having] a corner inside traditional banks' branches is not a bad idea* (V001).

For cooperatives, there are other strategies to promote microlending activities. Exploiting members' networks helps to increase the number of loans disbursed, but also to expand financial coverage and operate beyond MFI-client proximity and territoriality principles:

> *We do not advertise our business …. we are interested in people we know … We are not interested in territoriality, borrowers do not have to be from Emilia Romagna. We have financed people in Puglia, Sardinia and Piemonte, because [these people] reached us through our members.* (M002)

These partnerships, established by MFIs, are also innovative ways of channelling different public programmes that address the needs of the more excluded groups. Collaboration between MFIs and local authorities can favour the design of more effective and innovative 'social' financial products:

> *There are new poverty forms in the region. Those families that get their meals from the charity soup kitchens, even though they can afford a minimum rent.* (G001)

In this line, alliances between MFIs and charities with purely social objectives and focused on different vulnerable groups such as immigrants or women victims of abuse, were found to be a strategy to reach the poorest and more vulnerable in society. For example, immigrants have emerged in Emilia Romagna as a target for both entrepreneurial and personal microcredit products.

Even though microcredit has traditionally been targeted at low-income borrowers, our interviewees agreed on the difficulties of sustainably serving the lowest-income groups. In this case, partnerships were not perceived as facilitating access to these poorest individuals in a financially sustainable way. In the words of one of our respondents:

> *It is an ethical choice to take part in the social microcredit programmes and not a business choice.* (M001)

As a consequence, the income of prospective clients was perceived as crucial to assess their creditworthiness. One of the interviewees is clear about this:

> *If the borrower has not got an income … I can't understand how it is possible to repay …* (F001)

However, when the MFIs manage to find an alternative to asking for financial guarantees, such as the trust developed as a cooperative member, personal loans that cover any kind of financial need are considered less risky. For example, one of our interviewees reported:

> *Along with ordinary loans we also have an activity that we call mutual aid cash, which are smaller loans up to 7000 Euros to individuals without a specific project and who may need to go to the dentist or to buy a car … We do ask for trust guarantees and not for payslips or annual income.* (M002)

Microcredit risk management

Credit risk management and credit disbursement were considered by our interviewees to be related with the MFIs' ability to offer high-quality credit-plus and business development services to better fulfil the MFIs' social mission. These services - such as business planning, management mentoring and accounting training - can be defined as "devices offered in addition to loans that aim at increasing the chances for the project to succeed" (Bourlès and Cozarenco, 2014). However, from the perspective of a downscaling bank, business support services and mentoring represent an economic burden for both the microcredit provider and the microborrower:

> *For an efficient and effective [microcredit] programme it is necessary to invest in credit-plus services [that] should secure not only the repayment of the microcredit, but also a positive evolution and development of the activity itself.* (G001)

> *We don't offer mentoring services … because it is impossible to get paid for that … It would be very hard to regain the working hours that are usually necessary for this kind of loans.* (V001)

Banks collaborating with NBFIs were perceived to be willing to downscale to reach microentrepreneurs only in the presence of inter-sectoral partnerships. In these alliances, auxiliary services, screening and monitoring processes are centralised by a NBFI, which in turn relies on Government Microcredit Guarantees to manage risk and third-sector organisations and on volunteers to manage the costs of the credit-plus services. The bank in the sample stated that they were more likely to disburse microcredit directly when the risks were mitigated by Government Microcredit Guarantees and third-sector organisations delivered credit-plus services, which are required by law.

A NBFI in our sample corroborates that the cost of entrepreneurial microcredit is associated with higher risk of losses and large investments in screening processes:

> *The massive need of liquid assets expressed by enterprises … is not always assessable for us, for many reasons. It is crucial to understand if this need is due to a temporary necessity or simply means that the business activity is not sustainable.* (F001)

Personal microloans are in fact perceived as more appealing in terms of costs and risk. In this respect, one of our respondents said: "*Microloans to private citizens … offer larger profits … [and] are useful to cover the costs and the higher risk that you have with the entrepreneurial microcredit*" (M001).

There was a general perception that, because of more cost-effective delivery, lower interest rates could be offered when microfinance was supplied through interinstitutional partnerships. However, the income derived from interest rates was not perceived as sufficient to cover the costs of entrepreneurial microcredit: "*It is hard to pursue profitability against the spread between the borrowing rates and the cost of money (funding)*" (F001). Therefore, cross-selling activities of microfinance services between NBFIs, bank and private firms are pursued as a strategy to increase the profit and ease proximity between financially excluded individual and banks.

When alliances between NBFIs, banks, and the third sector occur, especially in the Italian earthquake-hit regions of Emilia Romagna and Abruzzo, entrepreneurial microcredit amounts can go over the ceilings recommended by the European Union, the average loan size increases, clients are not charged fees and credit-plus services are offered.

Table 4 *Product characteristics of the sampled MFIs and average loan size (2014-2015)*

		Emil Banca	**CxIT (guarantees)**[2]	**- PerMicro - CxIT**[3]	**Mag6**
Loan ceilings	Individual/Social microcredit	3,000 or 5,000	10,000	10,000	7,000
	Entrepreneurial microcredit	15,000 or 25,000 (over 25,000 with no Government Credit Guarantees and credit-plus services)	50,000	25,000	None
Average loan size (Euros)	Individual/Social microcredit	2,089	9,509	5,203	4,868
	Entrepreneurial microcredit	18,652	28,876	- 13,539 - 19,504	27,265
Fees (Euros)	Individual/Social microcredit	No	No	Yes (PerMicro)	No

[2] Data refer to 2014.

[3] CxIT disbursing directly microcredit.

	Entrepreneurial microcredit	Yes	No	Yes	No
Interest rate	Individual/Social microcredit	1.10 – 3.25%	3-month Euribor + 4.25	Commercial interest rates depending on sums borrowed (PerMicro)	Up to 8.5%
	Entrepreneurial microcredit	Fixed at 3% or variable 6-months Euribor rounded to 0,10+2	3-month Euribor + 4.25	- Commercial interest rates depending on sums borrowed (PerMicro) - 3-month Euribor + 5.50	Up to 8.5%
Requirements to access credit	Individual/Social microcredit	Social network/ Collaterals	Payslip	Social networks/social collaterals, income statements, payslip	Trust
	Entrepreneurial microcredit	Social network/ Collaterals	Social network/ collaterals	Social networks/ collaterals	Trust

The average loan size for entrepreneurial microcredit was found to be lower when MFIs, such as Emil Banca, could rely on the Microcredit Guarantees Schemes and third-sector organisations for credit-plus services. Average loan size for microenterprises can also be reduced when fees are applied to direct disbursements from specialised NBFI such as PerMicro and CxIT. Higher interest rates seem to apply to microentrepreneurs when there is direct disbursement of microcredit by a credit guarantor, with lower amounts of credit frequently being disbursed by these organisations, particularly when compared to their activity as credit guarantors (**Table 4**).

4.2 Regulation and MFIs' double bottom line

With regard to the new microcredit legislation in Italy, participants were invited to discuss their perceptions about the possible effects of the new regulation upon the operations of the microcredit providers and, especially, on their established partnerships.

Furthermore, some interviewees highlighted that a specialised microcredit market that prioritised the needs of financially excluded individuals would also purify the sector from market distortions. In this respect, powerful financial actors would avoid financial product segmentation, because it is considered detrimental for the social mission of microcredit.

The new capital requirements for MOs were perceived as key to enhance the sustainability and quality of microfinance operations in Italy. For example, one of our respondents stated that: "*[Capital adequacy] will contribute to sustain the sector and enhance the operations of highly specialised microcredit providers*" (P002). Another interviewee (P001) seemed to confirm this, suggesting that share capital, transparency and a focused social mission on people's financial inclusion would in fact enhance the impact of the microcredit activities, determining also the sustainability of the entire supply chain involved in the microfinance industry. Moreover, discussing also the prospects of a highly-regulated microcredit sector, he also expressed his perception of the need to extend the regulation on asset allocation and prudential supervision of NBFIs and banks to MOs, since, in his view, the microcredit sector experienced a distinctive growth.

On the contrary, the ratio between the volumes of social and entrepreneurial microcredit imposed by the regulator on specialised MFIs was perceived as problematic: "*The problem is that [*the legislation*] imposes limits on the number of microcredits addressed to families*" (M001). The provision of entrepreneurial microcredit was perceived as being costlier than the supply of social

microcredit. In turn, social microcredit disbursement emerged to be potentially more effective in helping microcredit operators achieve operational sustainability. Moreover, the legal restrictions on beneficiaries that regulation has imposed on MOs, especially for social microcredit, were also considered a distortion of the founding principles of autonomy and mutualism of cooperatives, as stated by one of our interviewee:

> *One of our members could still choose to borrow even without extreme need … because they did not want to go to a bank, but now they have to do it* [going to a bank]*, because if I'm not mistaken that* [social microcredit] *follows specific conditions … Therefore, it is no longer the borrower who turns to us instead going to a bank. What we have been doing until now does not correspond to what the legislation says (certain income types, unemployed people).* (M002)

In terms of interest rates, it was perceived that the introduction of caps in microfinance products would enhance the depth of outreach by contributing to include financially excluded individuals. As one interviewee puts it:

> *The aim of the legislation is to make microcredit more accessible … Small loans are those in which racquet can intervene more easily by applying usury interest rates to desperate people, desperate just for small loans that they cannot repay.* (P002)

However, our sampled practitioners perceived financial sustainability of MOs being at risk after the introduction of the new regulation due to interest rate caps being imposed. In this respect, one of our respondent said: "*Our choice [of being a NBFI] is clear because … the new legislation brings a series of limitations … in terms of interest rates above all*" (C001). Hence, being prudentially regulated as NBFI but without restrictive interest caps as for MOs emerged to be preferable for a specialised MFI. This was also confirmed by another of our respondents: "*The interest rate on private citizens' loans implies that it is not possible to do that activity in terms of economic sustainability*" (F001). Interest rates were also a concern when social microcredit is perceived as a non-profit activity of a bank. For example, M001: *"the profits we generate with profitable activities compensate other activities such as social microcredit".*

Outreach performances of MOs were also considered at risk by practitioners. For a regulated MO in our sample, the new law led to restrict potential borrowers only to economic or institutionalised activities, and therefore financially exclude groups of people living in the informal economy. In this respect, one respondent acknowledged that: "*What we fund are cooperatives, associations, but we used to fund also informal groups. However, the legislation has narrowed the field and we cannot finance informal groups anymore*" (M002). For a NBFI such as CxIT, which serves also microenterprises operating for more than 5 years, the prospects of limiting, as MO, its entrepreneurial microcredit activities to new microenterprises may undermine its social mission: "*[According to the regulation] the enterprises … must be in operation for less than five years. This means that an enterprise operating for more than five years cannot experience difficulties or access microcredit*". Moreover, a different interviewee from another MFI suggested that product developments and lateral programmes for financial and social inclusion that MOs could pursue would be affected: "*Legislation provides that the activity [of microcredit] is carried out in an exclusive way … This would have not been possible in our case*" (C001).

The restrictions that apply to MOs seem to indirectly affect also the operations of specialised microcredit providers such as PerMicro and CxIT, which have opted to be prudentially regulated as NBFIs. Assets allocation and RWAs at 6% required for financial intermediaries may impact on the social objectives of these institutions. In words of one of our interviewees: "*[The legislation]*

has an important impact at bureaucracy level … there is the risk that the target will be restricted … because you have to pay more attention to the risk" (F001).

Moreover, limiting the access to the microcredit sector for non-profit organisations that have to meet capital adequacy to be a MO may also impact on the role of a bank as provider of credit with no collaterals. One of the practitioners in our sample suggested that: "*[For credit institutions] there is total allocation of assets and share capital for the loan at 100%*" (F001). In this respect, the risk is not having non-profit organisations recognised in the microcredit sector as before the regulation was introduced. As stated by one of our interviewees: "*The regulation will not solve the operations of … associations and third sector organisations that are … the most widespread [in the microcredit sector]*" (M001). The processes of adaptation to the new rules have not been reported to be straightforward, even in the case of self-managed financial cooperatives.

Lack of legitimacy of non-profit organisations as MOs emerged therefore as a potential pathway to create a market vacuum in the social inclusion of vulnerable people through social microcredit. As suggested by one of the experts interviewed:

> *The regulator wanted to create a line between social and financial sustainability objectives, by facilitating financial intermediaries to disburse entrepreneurial microcredit and relegating social microcredit … to religious institutions and hybrid forms that had social objectives as priority.* (G001)

5. CONCLUSION

In Emilia Romagna, partnerships with different types of private and public actors in the microfinance scene were perceived as key for achieving breadth of outreach, customer proximity and to improve the financial and social performances of MFIs.

Different approaches to cooperation and interinstitutional alliances were identified. These partnerships were perceived to stimulate MFIs and banks to diversify their microcredit products and target groups, implement credit-plus services, fund microfinance operations and limit the costs to serve non-bankable individuals, and pursue their financial objectives and requirements. Partnerships also emerged as strategic for the achievement of social objectives of MFIs. We found that interinstitutional collaborations between NBFIs, commercial banks and the third sector could improve the outreach of MFIs to serve the more excluded individuals such as immigrants, young entrepreneurs and low-income households. Our results also highlight that this cooperation has benefited microborrowers as they have been included in the mainstream financial market as MFIs often offer banking products to their clients or they guarantee microloans from commercial banks that apply competitive interest rates.

On the other hand, our results highlight that financial requirements and social objectives of the microcredit providers in Emilia Romagna were perceived as hard to balance. In the case of social microcredit, partnerships between banks and third sector facilitated reaching the poorest clients. For example, for cooperative banks, a downscaling operation of this kind was perceived as risk and cost-free since the microlending programmes are managed and secured by third-sector partners. However, depth of outreach seems to be lower when a partnership between NBFI and a bank occurs. Proximity between clients and banks through the action of a MFI – which guarantees (CxIT) or sells (PerMicro) banking products to its clients – may lead to serve nearly-bankable and bankable individuals. In this respect, the type of social capital exploited for individual lending by the MFIs relates mainly to the borrowers' work environment, thus suggesting that microborrower's income stability makes the risk assessment easier and less costly

for a NBFI and represents a prospect of future bankability of the NBFI's clients for the bank. Further research is needed to better understand how Western MFIs exploit social capital as social collateral in their individual lending operations and whether co-participation of banks in European MFIs' governance can influence individual microlending contracts.

In the case of entrepreneurial microloans, Microcredit Guarantees Schemes promoted by the Italian Government were confirmed as the main driver for MFIs to offer lower-cost credit. However, the study shows that the effects of supplying guarantees can be twofold. Firstly, the guarantees boost the social objectives of a bank, which downscales its activities to poor entrepreneurs by lowering credit amounts supplied and activating collaborations with third-sector organisations to set up the microcredit programme and cover the expenses of the screening and business mentoring processes. Secondly, although the Microcredit Guarantees Schemes can encourage NBFIs to risk more by securing for free bank's loans to entrepreneurs, respondents perceive that this partnership tends to finance larger business projects, with higher sums of credit in specific disaster-hit areas. Although further analysis is needed to assess the relationship between loan sums, contingencies of the context in which MFIs operate and loan guarantees, the study also highlighted that NBFIs that disburse independently and with no loan guarantees tend to assess the risk more in-depth and concentrate on disbursing smaller sums of credits whilst charging higher fees for the borrowers. This might suggest that NBFI partnerships with commercial banks can favour cost-efficiency at the expense of reaching the poorer borrowers when loan guarantees from the government apply. However, further research is also necessary to assess the impact of Microcredit Guarantees Schemes in microfinance activity in Italy.

Given the partnership-based nature of microfinance in Emilia Romagna and the rules that the new legislation imposes on microcredit provision, we conclude that regulation may have a negative impact not only on the new MOs' sustainability, but also on NBFIs and banks. Most of the pre-reformed microcredit providers risk being excluded from the implementation of existing microcredit programmes, thus harming the partnerships model that in Emilia Romagna contributed to the development the sector and serve financially excluded people more than in other Italian regions. On the other side, the regulator's intentions to correct financial market failures and enhance the portfolio quality of the MFIs seems to reinforce the tensions in the double bottom line of the microfinance partnerships in Emilia Romagna. Poor entrepreneurs are now able to access low-cost microcredit if microcredit guarantees cover their default risks, but directly assessed by banks and NBFIs, which are now required to expose more their assets and better assess the risk. On the other hand, financially excluded individuals have higher access to credit when banks downscale or when NBFIs and MOs are able to pursue their financial requirements and adapt properly to the new set of rules.

Although to our knowledge this is the first paper exploring in depth how MFIs adapt the management of their double bottom line to a new regulatory framework in an advanced economy context, the findings are non-generalisable due to the qualitative nature of the research process. However, these findings are relevant for regulators and policy makers, and lay the groundwork for further research aiming at assessing pre-post mechanisms of regulation on MFIs operations through longitudinal studies. The importance of microfinance regulation in enabling the provision of social microcredit should be taken into consideration by all stakeholders in the sector. Furthermore, Government Microcredit Guarantee Schemes may play a crucial role in preventing the mission drift of MFIs and favouring financial inclusion. These conclusions need to be taken into account to mitigate the potential unintended effects of regulation on the microfinance sector and its outreach.

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