

## MICROCREDIT

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### *Abstract*

*Microcredit is a loan of a small amount, provided to beneficiary in the absence of appropriate collateral guarantee. In this paper we describe the main features of microcredit and its possible application as an alternative way to access to credit. Subsequently, we describe the evolution of this financial instrument in the last decades: the microcredit started in Bangladesh during '70 years, when Muhammad Yunus founded the Grameen Bank ([ETHICAL BANK](#)). Then, we describe the European framework and the Italian regulation, with the recent ministerial decrees. We offer some considerations about its structure, showing its potentials, but also the possible drawback effects, and finally we conclude.*

### *Definition*

Microcredit could be defined as the supply of «small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families» (Grameen Bank, What Is Microcredit?, [http://www.grameen.com/index.php?option=com\\_content&task=view&id=32&Itemid=91](http://www.grameen.com/index.php?option=com_content&task=view&id=32&Itemid=91)), or as the supply of loans «without guarantee of a low amount provided by financial intermediaries of different legal nature. Microcredit is provided to single person or group of people that haven't normal requisites to access traditional credit circuit, both for developing a formal or informal business and for socio-assistance initiatives» (translated by Becchetti, 2009: p. 594).

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Microcredit doesn't require that beneficiaries give collateral guarantees, consequently institutes that provide microcredit adopt different warranty systems (Becchetti, 2008; Ciravegna, 2003).

#### *Characteristics of microcredit*

Microcredit (Mc) includes a large range of different lending activities; however, all these ones have two main characteristics:

- a small amount;
- the absence of appropriate collateral guarantees produced by beneficiaries.

This last element represents the main difference with a traditional loan: microcredit is provided in the absence of appropriate collateral guarantees and this element "breaks" the link consolidated in traditional banking system between the supply of a loan and the ownership of sufficient collaterals by the beneficiary. This has created an oxymoron since banks are inclined to give money only to those who already have economic resources, and consequently they exclude those who need but don't have any asset (Becchetti, 2008).

Microcredit has both social inclusion and economic development scope, since it funds man and women with entrepreneurial ideas and strong professional skills, without sufficient personal resources for realizing their own business (Ciravegna, Limone, 2007). The meaning of microcredit does not match that of microfinance (Mf) ([MICROFINANCE \(Encyclopedia\)](#)) because the first represents only a part of the second. Microfinance includes different activities, among which the provision of small loans (that is microcredit), micro-insurances and micro-leasing, the collection of private savings and the supply of other financial services (Microcredit Summit Campaign, What Is Microfinance, <http://www.microcreditsummit.org/what-is-microfinance2.html>).

In relation to the economic sustainability of microcredit, in developing countries there have been many successful experiences, contrary to developed countries where

traditional banking dominates. The reasons are different: a high competition with traditional banks, the high demand of Mc but a constrained supply, the high operating costs and a rigid legal framework (Limone, 2007; Orsini, 2014). Researchers agree that the provision of microcredit has to tend toward an efficient management system, whereas there is an intense debate concerning its economic sustainability. Some stakeholders underline the relevance to gain a complete economic sustainability to supply microcredit for a long time; others highlight the importance to maximize social effects and positive externalities of Mc, even if it weakens the economic reliability of microcredit institutions (Becchetti, 2008; De Vincentiis, 2007).

#### *System of collateral guarantees*

Due to the absence of appropriate collateral guarantees, 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 analysing deeply 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 as a confidi<sup>2</sup> [link to "Confidi" voice of Bankpedia]) repay the loan if the debtor is insolvent (Isaia, 2007). The surety is an example of personal warranty;
- accessory warranties ([SUSTAINABLE FINANCE \(Encyclopedia\)](#)), 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.

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<sup>2</sup> A "Confidi" is a consortium that provides mutual guarantees. For other information, surf the following website: Patti Chiari, About Credit Guarantee Consortiums, <http://www.pattichiari.it/home/saperne-di-piu/risorse/tutti-gli-argomenti/speciale-migranti/english/enterprise/enterprise7.dot>.

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).

Microcredit can be provided to a group of beneficiaries following different schemes. The provision of microcredit to a group of recipients, called "group lending", is a pillar of "Grameen methodology", the scheme applied by Grameen Bank ([ETHICAL BANK](#)) to supply microcredit in Bangladesh. Recently, Grameen Bank philosophy has been diffusing in many different areas of the world by activities and initiatives of Grameen Foundation. The group lending is very common in rural areas of developing countries where social relationships are very close among members within a community, but it's rare in Europe where society is more individualistic and social relationships are less binding.

#### *Short history*

Microcredit under the modern meaning was introduced in Bangladesh during '70 years, when Muhammad Yunus founded the Grameen Bank (that means "Village Bank"). Grameen Bank started to supply small loans in the absence of appropriate collaterals. The beneficiaries were small groups, composed mostly by women. Grameen Bank helped millions of households to come out of misery by microcredit during the last forty years.

In 1997 the first session of Microcredit summit campaign was held in Washington (USA) on February 1997. This campaign aimed for supplying microcredit to 100 million of poor households in the world until 2005 (Microcredit Summit Campaign, <http://www.microcreditsummit.org/>). This goal was not achieved, but in eight years microcredit allowed to supply loans to 92 million of households, 66.6 million of them with a daily income less than a dollar. United Nations (UN) declared 2005 "International Year of Microcredit" (UN, 2003; UN, 2004).

The current target of Microcredit summit campaign is to provide microcredit to 175 million of households in extreme poverty until 2015, taking out from misery 100 million of them (Microcredit Summit Campaign, <http://www.microcreditsummit.org/>). The choice of 2015 as deadline for the new target is due to the correspondence with the term of the current UN Millenium Development Goals (MDGs)<sup>3</sup>.

#### *European framework*

According to law of European Union (EU), microcredit is a loan with a maximum amount of up to €25,000 (European Parliament, Council, 2013).

In 2011 European commission published an European Code of Good Conduct for Microcredit Provision, code updated on June 2013. This code is not binding for Mc operators, but it lists behaviours and good practices that are positively acknowledged by Mc institutions and stakeholders and that concern different aspects of a microcredit business. The respect of these practices advantages clients, investors, bankers, owners, regulation authorities and partner organisations. In relation to its application, «the Code of Good Conduct is primarily addressed to non-bank microcredit providers which make available to micro-entrepreneurs or self-employed people loans of up to €25,000» (European Commission, 2013).

#### *Italian regulation*

In Italy microcredit has been introduced officially in the national regulation by the legislative decree no. 141 of 13 August 2010. It modified articles n.111 and n.113 of "Testo Unico Bancario" (TUB), the italian code that regulates banking. In 2014 the Ministry of Economy and Finances published a decree that has made operational the above-mentioned national regulation (Ministry of Economy and Finances, 2014).

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<sup>3</sup> Regarding the MDGs, surf the following website: United Nations (UN), Millenium Development Goals, <http://www.un.org/millenniumgoals/>.

Microcredit is supplied in the absence of collaterals, but personal warranties and other forms of guarantees are allowed. The provider of a microcredit has to supply some consultant services to the debtor in order to support this one to manage his business or to reorganize his household balance sheet.

There are two categories of microcredit: Mc for entrepreneurial purposes, focused on micro-entrepreneurs and self-employed people, and Mc for social or solidarity purposes, focused on single persons in specific situations of socioeconomic vulnerability. In relation to the maximum amount of a microcredit, Mc for entrepreneurial purposes concerns loans of up to €25,000, and in some specific cases of up to €35,000; furthermore, the same beneficiary can receive different loans, one after the other. Otherwise, Mc for social purposes concerns financings of up to €10,000 and the provider has to supply this loan with better conditions than the prevalent ones in the reference market.

The microcredit providers are divided in two main categories: the traditional credit providers, as banks and financial intermediates, and the non-banking operators. The non-banking operators are regulated by article n.111 of "Testo Unico Bancario" and the above-mentioned ministerial decree, and they have to respect specific criteria.

Regarding the beneficiaries, microcredit for entrepreneurial purposes focuses on natural persons, partnerships and cooperatives: all these categories of recipients have to respect clear criteria relating their size, their debt level and their stay time on the market. Apart from some exceptions<sup>4</sup>, corporations and limited companies are kept out as possible recipients of microcredit. Microcredit for social and solidarity purposes focuses on natural persons that are in specific conditions of socioeconomic vulnerability, stated in details by the above-mentioned ministerial decree.

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<sup>4</sup> The "società a responsabilità limitata semplificata" (SRLS) is a corporation regulated by article 2463-bis of Italian Civil Code but it can access to microcredit.

### *General scheme of public intervention*

Currently, in most cases the programmes 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:

1. 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;
2. qualified operators, that select the potential beneficiaries;
3. banks, that supply effectively the loans;
4. social operators - in most cases subjects belonging to no-profit sector - that support the beneficiaries of a microcredit before and during the repaying period of each loan.

### *Microcredit's effects*

Analysing the microcredit, it's important to balance sensibly its merits and positive results with its real contraindications and potential drawback effects (Orsini, 2014). Microcredit can have various positive effects. Firstly, it improves the socioeconomic relationships within a community (Becchetti, 2008): in fact, the poor is involved in a business transaction, he receives faith by another person and he gains a respectable social acknowledgement within own community (Orsini, 2014). The selection of potential beneficiaries of microcredit isn't based on collaterals owned by a person, but on his business idea, moral qualities and professional skills (Orsini, 2014). Microcredit represents a possible way for a person to gain an economic independence and a higher social position. Moreover, micro-enterprises and small businesses ([SMALL AND MEDIUM SIZED ENTERPRISES - SMEs](#)) are often excluded from traditional credit circuit and consequently they can use microcredit to access to financings for making investments (Orsini, 2014).

In developing countries most of microcredit projects are focused on female entrepreneurship because the condition of women is usually worse than the men's one. Analysing different empiric surveys in developing countries, women who received a microcredit have on average a higher social status and better health conditions than the others (Bonaga, Tinessa, 2014).

In relation to the general issue of unemployment, microcredit doesn't represent a "magic" tool and it can't be the solution for all unemployed workers; however, microcredit could represent an useful instrument to support many people to gain an economic self-sufficiency. Consequently, it's very important to select carefully which people and business projects have to be financed by microcredit (Orsini, 2014).

In the author's opinion, microcredit burdens the public balance sheets less than the traditional non-repayable aids supplied by public bodies; furthermore, the Mc beneficiaries will engage deeply to invest in the best way the financings received since they have to repay their debts.

### *Microcredit in Italy*

Considering data until 31th December 2012, there were 172 operational programmes of microcredit in Italy, and 29 of them started in 2012. All these programmes have financed 12,418 beneficiaries, supplying €115,900,000.

There are four main categories of players that supply microcredit:

1. public bodies;
2. banks;
3. private non-banking subjects (non-banking operators, foundations, associations and the so called "Mutua AutoGestione"<sup>5</sup>);

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<sup>5</sup> The "Mutua Società per l'Autogestione" (MAGs) are mutual company under workers management with the form of cooperatives. Respecting solid ethic principles [link to "Sustainable Finance" voice of Bankpedia], the MAGs provide different services and one of these concerns the supply of loans to their associates. A possible link to deepen this topic is the following (available only in italian): MAG4. Strumenti di finanza etica e di Economia solidale, Chi Siamo, <http://www.mag4.it/chisiamo/le-mag.html>.



4. religious bodies.

According to data on 2012, most of programmes have been promoted both by private (53) and public (51) subjects. In relation to the beneficiaries, the private operators have provided microcredit to 4,048 beneficiaries, banks and religious bodies have supplied financings respectively to 2,914 and 2,612 recipients, and finally public bodies have provided loans to 2,844. Regarding the amount of money lent, the beneficiaries have received almost €42 million by private bodies and about €39 million by public ones (CamCom Universitas Mercatorum, Borgomeo, 2014, pp. 68-69). However, most of financial resources to grant microcredit have been supplied to other providers by banks (almost €99 million out of €116 million). Concerning the categories of beneficiaries, the natural persons have received nearly €64 million, while the legal persons have benefited from microcredit of €8,750,000; moreover, the programmes that funded indifferently natural and legal persons have provided more than €40 million. Considering data until 31st December 2012, in Italy the group lending appeared secondary because only about €3 million out of €116 have financed businesses of people joined in repaying groups of two or more units (CamCom Universitas Mercatorum, Borgomeo, 2014, pp. 70-71).

In relation to the geographical distribution of microcredit in Italy, considering data until 31 December 2012, Calabria, Piedmont and Tuscany were the three regions where the supply of microcredit seemed to be more widespread, with over 3,500 financings in each region. On the contrary, Valle d'Aosta, Trentino-Alto Adige, Friuli-Venezia Giulia, Umbria, Molise, Apulia and Campania were the regions with the fewest number of microcredits supplied (less than 500 in each of these regions). Most of programmes of microcredit had a regional or local range; in fact, only 16 among them had a national relevance (CamCom Universitas Mercatorum, Borgomeo, 2014: pag. 72-73).

Analysing the available data, 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 (CamCom Universitas Mercatorum, Borgomeo, 2014: pag. 68).

Finally, according to the National Agency for Microcredit it has supported the creation of nearly 20,000 jobs in Italy between 2011 and 2013 (National Agency for Microcredit, Lavoro: ENM, da Microcredito oltre 20mila Posti tra 2011-2013, <http://microcreditoitalia.org/images/pdf/lavoro.pdf>).

### *Conclusions*

The current debate about microcredit is evolving, but the literature confirms that microcredit can improve the financial sustainability of large number of persons, unable to access credit otherwise<sup>6</sup>.

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. However, 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 socio-economic context.

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<sup>6</sup> A full financial sustainability for a Mc provider is a situation where the interests on loans can cover both all operating costs, and the cost of financial resources that the provider collect sin the market to be able to supply microcredit.

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