The relationship between small and medium-sized social enterprises and banks

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Abstract

Purpose - This paper performs a critical analysis of the relationship between small and medium-sized social enterprises (SMSEs) and banks. Based on the conceptual framework for the analysis of SME credit availability developed by Berger and Udell (2006), this study aims to contribute to the current debate in two ways: (1) outlining the characteristics of the lending technologies currently used by banks and financial institutions to evaluate SMSEs when they apply for credit and (2) discussing, based on the results of the empirical analysis, the coherence of these systems from the social ecosystem perspective and identifying areas for possible improvement.

Design/methodology/approach – The paper develops a conceptual framework based on the model proposed by Berger and Udell (2006), which defines the characteristics of lending technologies that banks use to evaluate SMEs, and applies it to the case of SMSEs. To study the interplay of these lending technologies, the empirical analysis is based on a case study of five Italian banks. Data are collected from multiple sources to capture key dimensions of the problems analysed.

Findings – The paper provides empirical insight about the relationship between SMSEs and banks. The Italian case shows that the current lending infrastructure must be revised to support SMSE credit availability, and government policies affect the national financial institution structure. The relationship between SMSEs and Italian banks remains underdeveloped.

Social Implications – The research supports the scaling up of social business.

Originality/value - This paper fulfils an identified need to study how social enterprises' credit access can be enabled.

1. Introduction

This paper focuses on the credit access problem for small- and medium-sized social enterprises (SMSEs), analysing their complex relationships with different types of banks. This topic has attracted growing attention in recent years, with several authors calling for SMSEs to diversify their funding streams in order to survive in cyclical environments and be able to scale (Nicholls and Paton, 2009; Grimm *et al.,* 2013; Salim and Ellingstad, 2016; Arena *et al.*, 2018).

Typically, SMSEs rely heavily on grants and public funding (Kerlin, 2013). They operate based on funding from traditional grant makers such as philanthropic foundations, corporations and government agencies (Dees and Dolby, 1996; Dees, 1998) to support their social mission. SMSEs are highly embedded in the community, with strong relationships with different groups of stakeholders (Mair and Martì, 2006; Dacin *et al.*, 2010). These relationships represent a relevant source of SMSEs' legitimacy (Teasdale, 2010).

However, in recent years, it has become clear that a funding model centred on grants and public funding is not sustainable in the long term, for three main reasons (Sunley and Pinch, 2012). First, the sovereign debt crisis has reduced the spending capacity of grant makers and public administrations, putting SMSEs under funding pressure. Second, these traditional funding sources are generally tied up in specific projects and are limited in their amount and time horizon; thus, they are not coherent with the scaling strategies of SMSEs, which require a more stable flow of money over a longer time horizon (Achleitner *et al.,* 2014). Finally, the tendency to purely rely on non-commercial financial sources can lead to a problem of "grant dependency", whereby diversifying funding streams becomes more increasingly difficult (Fraser, 2007; Seddon *et al.*, 2014). On the one hand, SMSEs are framed by a charitable mindset and are reluctant to take on commercial finance, particularly if they can access non-commercial sources relatively easily (Maier *et al.*, 2016). On the other hand, such a financial structure makes these organizations risky prospects for mainstream investors (Karaphillis *et al.,* 2010).

Although scholars and practitioners widely recognize that it is important for SMSEs to diversify their funding sources by accessing credit and other forms of commercial finance, recent research shows that the majority of SMSEs, similar to other social business organizations, continue to rely on public sector grants (Sunley and Pinch, 2012). Furthermore, even when SMSEs apply for credit, only a limited percentage of applicants obtain the requested funding because banks and financial institutions are generally reluctant to finance these types of organizations (Kickul and Lyons, 2015).

This consideration has opened a debate concerning the barriers and problems that SMSEs encounter when they try to access credit to fund their activities (Kingston and Bolton, 2004; Flockhart, 2005; Korosec and Berman, 2006). First, SMSEs share the problems that are typical of other SMEs due to certain characteristics that are inherent to many small-sized organizations. They generally have a low level of structuration, which is reflected in the lack of formal organizational arrangements and unsophisticated accounting and control systems (which is easily explained by the scarcity of financial resources) (Bull, 2007; Costa *et al.,* 2011; Bengo *et al.,* 2016). This problem is amplified by the lack of collateral and the intangibility of assets that strengthen a (perceived) negative correlation between firm size and the probability of insolvency (Udell, 2004; Scellato, 2007; Arena *et al.,* 2018). Furthermore, banks are typically less aware of the characteristics of social business organizations in terms of their business model, organizational structure and governance (Fraser, 2007; Chertok *et al.,* 2008). Since banks are less familiar with (or not interested in) a business model that generates both social and financial returns, they are very cautious about investing in SMSEs (Bank of England, 2003; Arena *et al.,* 2016).

Based on the above considerations, this paper aims to contribute to the current debate in two ways: (1) outlining the characteristics of the lending technologies that are currently used by banks and financial institutions to evaluate SMSEs when they apply for credit and (2) discussing, based on the results of the empirical analysis, the coherence of these systems from the social ecosystem perspective and identifying areas for possible improvement.

The rest of the paper is organized as follows. Section 2 introduces the research framework, which is based on the model proposed by Berger and Udell (2006). Their framework focuses on the lending technologies, financial institution structure and lending infrastructure and the interplay of these elements determines SMEs' credit availability, and it is deployed specifically in reference to SMSEs in this study. Section 3 outlines the research method, describing the criteria used for selecting the cases and collecting and analysing the data. Section 4 presents the study results regarding the interplay among lending infrastructure, financial institution structure, and lending technologies. Finally, in section 5, we identify the problematic factors concerning the lending technologies used by banks and their impact on SMSEs' access to credit, and we discuss the implications of this work.

2. Conceptual Framework

This paper aims to outline the characteristics of the lending technologies that banks use to evaluate SMSEs when they apply for credit and critically analyse the implications of current practices for SMSE credit access. With this aim, we refer to the conceptual framework proposed by Berger and Udell in 2006, which focuses on the relationship between different lending technologies and credit availability for SMEs. This framework comprises three main elements: lending technologies, financial institution structure and lending infrastructure. The interplay of these three building blocks determines SMEs' credit availability. In the following, we define these three elements, and we apply them to the case of SMSEs.

2.1 The lending technologies

Berger and Udell (2006) define a lending technology as "a unique combination of primary information source, screening and underwriting policies/procedures, loan contract structure, and monitoring strategies/mechanisms" (Berger and Udell, 2006, p. 2946). More generally, the authors categorize lending technologies into two types: hard technologies (or transactions lending), which are based primarily on quantitative data, and soft technologies (or relationship lending), which are based primarily on qualitative information. Obviously, all lending technologies employ some combination of hard and soft information, but the definitions of hard and soft technologies are based on the principal or most critical source of information employed in the screening, underwriting, and monitoring of credit (Berger and Black, 2011).

In the context of SMSEs, relevant lending technologies include financial statement lending, asset-based lending, small business credit scoring and relationship lending. Financial statement lending is a transaction technology based primarily on the strength of a borrower's financial statements, as the lender views the expected future cash flow of the organization as the primary source of repayment. To access credit, the borrower should have informative financial statements and a strong financial condition, as reflected in the financial ratios calculated from these statements. Asset-based lending is a transaction lending technology in which financial institutions focus on a subset of the firm's assets, which are pledged as collateral, as the primary source of repayment, and the liquidation value of the collateral always has to exceed the credit exposure (Udell, 2004). Under asset-based lending, the extension of credit is primarily based on the value of the collateral rather than the overall creditworthiness of the firm. Small business credit scoring is a transaction technology based primarily on hard information about the owner (typically personal data) and the firm, often obtained from commercial credit bureaus.

Obviously, all of these lending technologies are expected to be affected by the specificities of SMSEs. SMSE financial statements and resource composition typically reflect the characteristics of the SMSE business model. For instance, revenues are composed of a mix of sources (including contracts with public administrations and donations). Physical assets are generally limited, meaning that SMSEs have fewer assets available to use as loan security (Fraser, 2007). On the other hand, due to their social mission, SMSEs are usually highly embedded in the community and have strong relationships with different groups of stakeholders, which can account for unregistered intangible assets (Dacin *et al.,* 2010; Ramírez *et al.,* 2011).

2.2 Financial institution structure

The second element of the framework is represented by the financial institution structure, which refers to the structural characteristics of financial institutions and their effects on the feasibility of the use of the above lending technologies to fund the target organizations. These characteristics traditionally include bank size, branch capillarity, and foreign versus domestic ownership. For instance, large institutions are expected to favour transaction lending because of the possibility of exploiting scale economies in the processing of hard information. In contrast, small institutions are expected to favour relationship lending because it is generally easier for them to collect soft information, as they are generally closer to local clients, and to process and transmit this information through lean communication channels that are typical of small organizations.

In the context of SMSEs' access to credit, a structural factor that has emerged only recently and appears particularly relevant is the type of bank. In recent years, the banking system has witnessed the rise of new types of banks, including purely social banks or hybrid entities (Austin *et al.,* 2006). As a result, the key financial players in the banking system that provide credit to SMSEs may be classified as

- Traditional and cooperative banks with products for social business;

- Specialized banks within a group;
- Social banks.

The first category refers to "traditional" financial institutions, including cooperative banks. The diffusion of SMSEs and the recognition of the specificities of these organizations has induced many traditional financial institutions to develop specific products and services for social business organizations that are generally characterized by favourable banking conditions. The second category includes specialized banks typically controlled by a traditional financial group. Large financial groups have started to establish a separate branch or a subsidiary dedicated to managing financial products targeting the social business sector. From an operational perspective, these institutions are often dependent on external donations and borrow funds from the group for financing their activities. Finally, social banks are financial institutions that specifically aim to provide funding to organizations that aim to create social value (Edery, 2006; Weber, 2013), and their products and services have been designed to reflect this objective (Geobey *et al.,* 2012; Martin and Osberg, 2007).

2.3 The lending infrastructure

Finally, Berger and Udell (2006) define the lending infrastructure as the country ecosystem in terms of the information environment; legal, judicial and bankruptcy environments; and social and regulatory environments. All of these elements affect credit availability by influencing the extent to which the different lending technologies may be legally and profitably employed (Berger and Udell, 2006).

Traditionally, particular attention has been given to the accounting infrastructure and the sharing of information. Many lending technologies rely on the analysis of financial statement data, which are at the basis of financial statement lending but are also important for many components of loan contracting associated with other lending technologies (e.g., asset-based lending). Obviously, the reliability of these financial data and the possibility of easy access to historical financial statements and credit information (for instance, through commercial credit bureaus) are strongly related to the possibility of granting access to credit to an organization. In the case of SMSEs, this issue is intertwined with the problem of properly reporting the contribution of these organizations to society (i.e., social impact), which in turn influences their ability to access public financial resources (with a positive impact in terms of financial sustainability). As highlighted above, performance measurement and reporting practices are still underdeveloped among SMSEs (Greiling, 2010; Bagnoli and Megali, 2011; Mouchamps, 2014; Arena *et al.*, 2015, Bengo *et al.*, 2016) because there is no shared and common framework for measurement. Policy makers are currently starting to introduce some specific requirements in this regard, such as the establishment of third and independent bodies to foster more transparent practices, as well as mandatory reporting practices in certain countries (e.g., Italy).

Second, legal, judicial, and bankruptcy environments are country specific and refer to the rule of law as it relates to the extension of credit. The legal environment consists of commercial laws that specify the property rights associated with a commercial transaction.

Finally, the social and regulatory environment broadly refers to the contextual socio-economic factors that characterize a specific country. The social environment, in particular, is likely to influence relationship lending because social norms, religion, and culture may determine and affect the production of soft information and the ability of banks to use this information to forge relationships. In the context of SMSEs, this concept should be extended to incorporate the key features of the social entrepreneurship ecosystem and, in particular, the regulation of the SMSE system to capture the specificities of the interplay between financial players and SMSEs.

To this aim, it is important to recall that the regulatory framework concerning social enterprises (SEs) around European countries is currently highly fragmented. The lack of legal recognition of

SEs in many countries makes it difficult for authorities to design and target specialist support or fiscal incentives for these organizations.

3. Methodology

In this section, we first outline the procedure followed for collecting and analysing the data. Then, we briefly outline the key characteristics of the Italian social entrepreneurship ecosystem to clarify the key features of the entities under investigation.

3.1 Data collection

To study the interplay of lending infrastructure, financial institution structure and lending technologies, the empirical analysis was based on a case study of five Italian banks.

The selected institutions cover the three categories identified in our conceptual framework and include a social bank, a specialized bank (that is part of a large financial group), a cooperative bank, and two traditional banks with different specific products (one Italian and one international bank). These organizations were identified after a preliminary analysis of their websites and other public sources, with the aim to select banks that were active in providing services to social business organizations. Other criteria that drove the case selection were the existence and type of financial instruments dedicated to social business organizations, the presence of initiatives aimed at these organizations (e.g., funding to support social projects or studies and report on social business actors), and the participation of the financial institution in relevant initiatives concerned with the social business sector (i.e., Italian Social Impact Investment Task Force established in the G8 in 2014).

In detail, *Aiace* is the only Italian social bank, *Antigone* is the only Italian specialized bank, and *Filottete* is the main Italian cooperative group (or rural bank, based on the Italian system). To extend the analysis, we included two traditional banks that complied with the above criteria: *Edipo*, the only traditional Italian bank (commercial) among the top three banking groups with products for SMSEs (the bank is the third largest commercial banking group by market capitalization in Italy, with a market share of over 5%). Finally, we included an international traditional bank (*Elettra*), for which Italy represents the first European market after its origin country.

The following table shows the selected banks and their main characteristics.

Table 1: Case settings

To capture key dimensions of the problems analysed, data were collected from multiple sources (Yin, 1994), including semi-structured interviews, official documents and presentations, archives, direct observation and internal documents usually not available to the public. The primary data source was semi-structured interviews (Goldman and McDonald, 1987) with the head of the bank / subsidiary / unit dedicated to social business and the people in charge of the evaluation process of these clients. The interviewees were selected according to their responsibility for the credit delivery process. This resulted in diversification of our informants, who occupied the roles of president/CEO, head of portfolio management, third sector manager, head of rating and monitoring, and manager of corporate social responsibility. The first interview was conducted with the CEO / director of each bank. During these interviews, the CEO identified other suitable contacts for us to delve further into the different themes.

A total of 13 interviews were conducted (see Table 2). We also had the opportunity to enrich the data collected with follow-up and informal discussions with the above informants and other representatives at the same institutions.

Table 2: Interviewees

Each interview lasted between 60 and 120 minutes. All interviews were recorded and transcribed, and each transcript was sent to the interviewees for verification. The interviews focused on the three elements of the conceptual framework. In particular, they aimed to understand the lending technologies used by these banks (with specific attention to what systems they currently used to evaluate social business organizations) and how these lending technologies were influenced by the specific characteristics of the single institutions and the surrounding ecosystem. The interview guide is available in **annex 1.**

3.2 Data analysis

To analyse the data, we used within-case and cross-case analyses (Eisenhardt and Graebner, 2007). In a first step, we analysed each individual company, preparing case study write-ups that triangulated all our data for each site. The transcripts of the interviews and the archival materials underwent a content analysis to highlight emergent themes pertaining to the conceptual elements (lending technologies, financial institution structure, lending infrastructure). The narrative of each case was developed by combining the accounts of different interviewees around these themes. Once we completed the within-case analysis, we compared evidence across different cases to identify divergences and convergences. We searched for distinct patterns and for plausible explanations of the observed differences, trying to discriminate between local contingencies and more general regularities. With this scope, we constructed comparative tables to identify discriminating variables that could explain similarities and differences in the pattern analysed. This second level of comparison enabled us to select a set of facts that were more general in scope than each case alone and to interpret our findings. In the next section, the cross-case insights derived from this analysis are illustrated, with specificities from the individual cases.

4. Results

This section is divided into three parts, one for each component of our framework—lending infrastructure, financial institution infrastructure and lending technologies—with a specific focus on the evaluation system.

4.1 The Italian lending infrastructure

To disentangle the factors that can explain SMSEs' access to credit, the analysis of the lending infrastructure specifically focused on the interplay of the financial ecosystem (characterized by its own rules and regulations) and the Italian social entrepreneurship ecosystem.

As previously highlighted, the Italian financial ecosystem is highly informed by the European banking regulation and, in particular, by Basel 2. This regulation puts particular emphasis on the monitoring of credit risk through the calculation of risk-weighted assets (RWA).

After the recent financial crisis, Basel 3 introduced even more stringent measures concerning capital requirements (increasing the supervisory capital held by banks against credit risk). The consequence of this intervention has been an increase in the average cost of loans for organizations that want to access credit, with a particularly depressing effect on SMEs.

To try to reduce this effect, the Italian Banking Association with "Confindustria" and the Italian Alliance of cooperatives have proposed the application of a corrective factor in the calculation of RWA for the SMEs to compensate for the quantitative increase in the minimum capital. Some Italian banks have started discussing the possibility of introducing this corrective factor for social businesses organizations too, even if no clear position has yet emerged. Another initiative worth of mentioning is the extension of the Central Guarantee Fund for SMEs to SEs (Interministerial Decree of 12.27.2013). The purpose of this fund is to promote SMEs' access to commercial finance by providing a public guarantee that complements (and often replaces) the collateral provided by SMEs. The extension of this fund to SMSEs could help remove some of the barriers they encounter in connection to hard lending technologies (as discussed in the following sections).

4.2 The financial institution structure

The financial institution structure refers to the key characteristics of the financial institutions under investigation.

From a market perspective, it is worth noting that the Italian banking system is characterized by the presence of a few large firms that manage about half of total loans and an abundance of small local banks that are typically cooperative banks operating in restricted territorial areas (Coccorese, 2013). This configuration is the result of a process of consolidation that started in the beginning of the nineties and has forced commercial banks to search for scale and scope economies with the aim of increasing their efficiency.

Concerning, more specifically, the relationship between banks and SEs, the Italian G8 Social Impact Investment Task Force reported a fragmented picture. About 300 Italian commercial banks offer loans to non-profit organizations and SEs, at a total amount of about € 30 billion (Felici *et al.,* 2012), while 380 Italian cooperative banks have about € 130 billion in assets (distributed among households, SMEs, and non-profit institutions).

The five banks analysed in this paper are paradigmatic of different financial institution structures, including a social bank (*Aiace*), a specialized bank that is part of a large international group (*Antigone*), a cooperative bank (*Filottete*) and two traditional banks (one local bank, *Edipo*, and one international bank, *Elettra*). *Aiace*, the social bank, is a stand-alone model; it has almost 40,000 members, including 32,044 individuals and 6,267 organizations with seventeen bank branches. *Antigone*, the specialized bank, operates with two dedicated branches and 60 financial shops, and it serves 250,000 non-profit organizations in Italy. It is an independent legal entity within a leading banking group in Italy, with approximately 4.100 branches and 11.1 million customers. *Filottete*, the cooperative bank, is a stand-alone entity that adheres to the network of the Italian Cooperative Credit and has 46 branches. *Edipo*, the traditional local bank, is one of the largest Italian commercial banking groups in terms of market caps, with 1,560 branches, mainly concentrated in the wealthiest areas of the country. Finally, *Elettra*, the traditional international bank, is one of the leading investment banks globally, with about 3,000 branches in over 70 countries. Italy represents its second European market, with 550 retail outlets nationwide. This institute is one of the most important international groups in the country.

Table 3: Financial institution structure

Given the objective of this work, particular attention is given to the characteristics of the analysed banks that are most related to how they address SMSEs / social business organizations. In detail, we focus on the following issues: the banks' level of activity in the social business sector and the relative weight within their bank portfolio; their motivations for targeting SMSEs / social business organizations; the forms of financing and services offered to SMSEs / social business organizations; and the related risk exposure.

The interviews highlight that the weight of SMSEs / social business organizations is highest in social banks, followed by specialized banks that are part of a larger financial institution and finally traditional banks. One hundred percent of *Antigone*'s portfolio comprises SMSEs / social business organizations, whereas this figure is 70% for *Aiace*'s portfolio. For the other banks, this figure is drastically reduced, as low as 1%.

These banks had diverse reasons for starting to look at social business organizations as prospective clients. Social banks and specialized banks were specifically created to target this market segment; only later did they start to include as possible clients for-profit organizations with specific features that were coherent with environmental, social and governance criteria. This clearly emerges from the social bank's mission:

> "The idea behind *Aiace* consists of creating a place where savers, driven by the common desire for a more transparent and responsible management of financial resources, may meet socio-economic initiatives, inspired by the

> values of sustainable social and human development". (*Aiace* official document)

The specialized bank cites the same values:

> "(...) the Company's purpose is the creation of social value, ensuring, all the time, the sustainability of its operations (...). The Company finances the most deserving non-profit initiatives aimed at providing services to individuals, disseminating culture and education, and promoting access to and safeguarding the environment and the cultural heritage". (*Antigone* official document)

The other banks started to turn to SMSEs / social business organizations after the financial crisis because they recognized the potential growth of the social business market and therefore the opportunity to develop some specific financial instruments for this sector, as *Edipo*'s Non-Profit Coordinator explains in the following quote.

> "Some years ago, we asked ourselves if the traditional and generalist approach of a commercial bank that makes no distinction between small businesses and third sector organizations could still be effective in a strongly changing environment characterized by the crisis of the welfare state. This approach had proven to be successful for us in reaching above-average market shares in the past. But was it still the right way? The answer was no.[…] It was therefore imperative to take the next step because we strongly believe that the world of social economics will have to see banks and financial institutions as partners, and that has rarely been the case in the past". (Non-Profit Coordinator at *Edipo*)

Moving to the financial services offered to SMSEs / social business organizations, all banks, with the exception of *Elettra*, have complemented their traditional offerings with services dedicated to SMSEs, such as daily operations management, support for fundraising activities, and training and business plan coaching for social impact start-ups. The reasons behind these services are rooted in the need to strengthen the management skills of SMSEs while simultaneously enabling the bank to acquire more complete information.

Furthermore, two banks (*Edipo* and *Elettra*) developed dedicated financial instruments for SMSEs, i.e., social bonds. *Edipo* offers five different types of social bonds: “zero coupon”, “fixed rate”, “fixed rate step up / step down”, “floating rate” and “mixed rate”. These loans are offered at competitive terms and conditions for amounts ranging from €15,000 to €500,000. Still, they maintain a “donation approach”, as recognized also by *Elettra*’s Managing Director and Head of Investments and Insurances:

> “We reached the first social bond emission. It is basically a grant, a donation of a certain amount in support of a specific project”. (Managing Director and Head of Investments and Insurances at *Elettra*)

Notably, all analysed banks expressed overall satisfaction regarding the default rate of their social business clients since the non-performing loan rate of SEs was lower than that of profit-oriented organizations.

4.3 Lending technologies

This section focuses on the lending technologies used by the five analysed banks. They typically adopt a mix of lending technologies (financial statement lending, asset-based lending, relationship lending, and small business credit scoring), though with different levels of emphasis. Thus, the results are presented according to the type of lending technologies.

With regard to financial statement lending, all banks require their prospect clients to provide key financial figures based on their financial statements. However, differences arise concerning the level of details in this information. In particular, *Aiace* requires financial statements to be reclassified according to the criteria of the Agency for Third Sector because such reclassification is considered more appropriate for capturing the specificities of social business organizations. A practical example of the corrections that are applied when using this reclassification is provided by the introduction of the item "other revenues" within the item "ordinary operations", to be complemented by qualitative information about the fundraising activity. *Filottete* and *Edipo*, though not requiring the whole reclassification, require information about a prospective client's self-financing through a mix of resources: revenues from public administration, grants, donations, and fiscal contributions (5 x 1000).

Asset-based lending consists of a loan that is secured by a collateral, typically represented by tangible assets, such as inventories and account receivables. In the case of SMSEs, however, the most relevant collateral is constituted by intangible and relational assets, leading to a relevant degree of overlapping with relationship lending.

> "We consider the intangible assets, which are often poorly documented". (Manager of Development Financial Assets at *Antigone*)

> "It is hard to give credit to these organizations, considering only the traditional elements. However, since we know that Italian SMEs are undercapitalized and these organizations are even more undercapitalized than SMEs, we look for additional information that captures the aspects that we could define as more social, such as their relationship with the communities. This is really something that could ensure more reliability" (Manager of Corporate Social Responsibility at *Edipo*).

This specificity is reflected in the information concerning intangible and relational assets that are systematically collected in the analysed cases. *Aiace* requires diversified information, including the governance system, the relationship with stakeholders, and on-going contracts. *Antigone* requires information about the professional experience of the entrepreneur, the reputation of the organization (whether it has won any important tenders or quality awards) and non-registered assets that can be used as collateral. Examples of such collateral are the financial support of shareholders, associates, and presidents. Furthermore, *Antigone* analyses the presence of third parties available to support the organization in case it struggles.

> "We know that even in the absence of a multi-year contract, a religious body will never let fail an organization it works with and that if necessary, it will cover the debt; therefore, we consider this as an asset". (Manager of Development Financial Assets at *Antigone*)

Filottete requests guarantees regarding governance, information about the planning and control instruments adopted, quality certifications, and ethical charters and asks for information about the term served by administrators and board members as well as the turnover rate. *Antigone* also evaluates initiatives in favour of their own employees, such as integrative health care, mobility, and training. The other bank adopts asset-based lending technology in a more traditional way.

> "Referring specifically to the social enterprise, we evaluate the initiatives in favour of its employees, such as health, integrative care, mobility, training in number of man / days, and so on. Then, though not on social values, we analyse the managerial and organizational tools that the company uses, such as planning and control instruments, the quality certification, the charter of ethics values". (President of *Antigone)*

Another element that is often evaluated as a part of relationship lending is the affiliation to a network. *Aiace*, *Edipo* and *Antigone* consider it as a proxy for lowering the overall risk and therefore consider it a guarantee. For this reason, they request information about the rooting and integrity of a social enterprise on its territory of reference, its affiliation with supporting networks and its good reputation.

Finally, with regard the credit scoring models adopted by the banks analysed, the situation was more diversified.

Elettra relies exactly on the same credit scoring model developed for for-profit enterprises. In this case, SMSEs are evaluated based on the same evaluation process and instruments that are adopted for-profit companies.

> "…No, definitely, there is not an ad hoc model for the evaluation of social enterprises, as they are not a relevant part of our portfolio… in the event that the assessment of a specific social enterprise is different from expectations, or that the available information is not sufficient for trusting the output of the rating system, the credit officer has the possibility to make the decision that feels most appropriate". (Director of Portfolio Management at *Elettra*)

Aiace and *Antigone*, on the contrary, use a credit scoring model that has been specifically developed for SMSEs / social business organizations (though *Antigone* is complementing this credit scoring model with the official rating adopted by the group it belongs to). Both of these credit scoring models rely on two components. The first is a set of performance indicators that try and capture the specificities of SEs in order to predict the ability of the organization to repay the loan it has applied for. In this respect, set of indicators used by *Aiace* are mostly adaptations of the indicators used for for-profit organizations. In contrast, the *Antigone* model includes specific indicators, such as the balance and management statements defined by the Agency's guidelines for non-profit organizations, or fundraising management. The second component of the scoring model is r a socio-cultural evaluation that is based on a survey. *Aiace*'s survey focuses on legal status, environmental issues, democratic governance, gender equality, and social impact. *Antigone*'s survey asks, for example, how long the company has been active, the entrepreneurs'' experience, whether the company has social recognition from the territory, and whether it has won major tenders or quality awards. Another important aspect is the analysis of fundraising and third-party funding to evaluate whether there is someone willing to help during difficult situations. The results of the survey are then transformed into a score that is entered into the scoring model.

Moreover, *Edipo* and *Filottete* use different scoring models depending on the financial instruments for which SMSEs apply. When SMSEs apply for traditional loans, these banks use the same credit scoring models created for the evaluation of for-profit enterprises. When SMSEs apply for financial instruments that have been specifically conceived for social business organizations, they base their evaluation on a different scoring system. These scoring systems rely on both quantitative indicators to evaluate the repayment capacity of social business organizations according to their peculiarities and qualitative indicators to examine the value systems of the presented projects. In this case, the chance of default is determined with the credit scoring model adopted for profit-oriented enterprises, while the integrative instruments allow the credit institution to offer the client better conditions.

Another aspect that has emerged from our analysis is that most banks believe that it is crucial to establish a good relationship with non-profit clients. This relationship allows the banks to gather more information about the organizations and to perform more precise and detailed social evaluations.

Finally, it is worth noting that all the analysed banks claim to be currently engaged in the development of new instruments for evaluating SMSE creditworthiness. Those credit institutions that are already adopting certain tailored lending technologies now have consistent historical data to verify the effectiveness of their models and refine them accordingly. Those banks that are still using the model developed for for-profit enterprises are committed to building ad hoc tools for SMSEs and social business organizations because they are aware of the weaknesses associated with a standard evaluation.

> "The effort that we are exerting with this attempt to create a scoring method is to build up a more standardized system for assessing these organizations... lately, we have begun to make even more in-depth evaluations, which we call Advanced Social Evaluations". (President of *Elettra*)

> "Now, we are beginning to re-examine all the data to see if it is necessary to re-think our criteria or fix these criteria. After having used, for 5 years, our structured group model, we think it is time to review it. In particular, for us, it is necessary to recalculate the weights we use with SMSEs". (Head of rating and monitoring at *Antigone*)

> "We currently use a credit score model, used by the cooperative banks, which is integrated with an internal system of performance measurement, which matches different data series... Our idea for the new credit scoring model is to take what's good in these two systems and integrate them with a tool to assess the socio-cultural impact". (Head of Development of *Filottete*).

Table 4 summarizes the characteristics of the lending technologies for each bank.

Table 4: Lending technologies for each bank

5. Discussion and Conclusion

The paper aims to contribute to the debate regarding the relationship between SMSEs and banks, paying particular attention to the lending technologies that are currently employed by financial institutions when dealing with SMSEs and the effects of these practices on SMSEs' access to credit. The empirical analysis is framed by the model proposed by Berger and Udell (2006), which focuses on the relationship between different lending technologies and credit available to SMEs, identifying three conceptual elements: lending technologies, financial institution structure and lending infrastructure.

Based on this framework, the paper analyses the characteristics of the lending technologies that are currently used in five Italian banks (a social bank, a specialized bank, a cooperative bank, and two traditional banks) with different products targeting SMSEs. It examines the interplay between these lending technologies and the financial institution structure and the lending infrastructure.

The empirical analysis highlighted that the relationship between Italian banks and the social entrepreneurship ecosystem is diversified and articulated. The analysed cases showed a relevant degree of heterogeneity. The social banks and specialized banks have developed SMSE-specific lending technologies that use credit scoring systems specifically for SMSEs, require significantly different information and pay particular attention to intangibles.

Thus far, the lack of a significant track record concerning the performance of loans granted to SMSEs has prevented the evaluation of the effectiveness of these new lending technologies compared to traditional ones. However, social and specialized banks in particular have started to build a significant data set, enabling a comparison of the effectiveness of the results of the instruments created ad hoc for SMSEs against the more traditional systems. This consideration leads to a first area that could be developed in future research paths and represents a recommendation for bank managers and policy makers. Both could build appropriate databases and release public data by harmonizing the sources and making them inter-operable and by developing public-private partnership schemes that facilitate the release and integration of private sector data with public sector data.

A second result of the empirical analysis is related to the problems that traditional banks, in particular, currently face in developing and using new evaluation systems, due to the rigidity of the sector requirements and the governance and risk management mechanisms that are typical of these institutions (which, in turn, are in place to verify that the above requirements are actually respected). This situation often results in the (im)possibility of granting credit to SMSEs when they are not compliant with all the bank requirements. Again, this complex relationship could introduce an area for future research to look at the impact of governance and risk management mechanisms on SEs' access to credit and foster a relevant redesign of these governance arrangements. Moreover, this path moves the problem from the technical level to the governance level. The government should formulate a lending infrastructure that integrates a soft-governance approach in the process of determining a shared evaluation system, and the government should play a dual role. The first role is to provide support to less powerful bodies, i.e., SMEs, in consolidating specific technical skills and abilities. The second is to be a guarantor of a composition of balanced and harmonious interests among all players involved (Bengo, 2018)

The third issue that emerges from this research is represented by possible areas for improvement in relation to different lending technologies, enabling them to better capture the level of risk exposure of a SMSE. Starting from financial statement lending, the loan contract, which arises out of the analysis of these financial statements, could be integrated to reflect also the mix of resources used by SMSEs. Regarding asset-based lending, a SMSE typically has fewer assets available to use as loan security, but it has many different types of unregistered intangibles that are considered a sort of social collateral. One possibility could be to find a way to include the social collateral in the evaluation of SMSE creditworthiness. Obviously, this is not simple because there may be constraints related to the social mission on how assets are disposed, or the organizations itself might be reticent to use some community assets as security (Sunley and Pinch, 2012). Relationship lending, where a financial institution relies primarily on soft information, better captures a wide variety of information about SMSEs. Due to their social mission, SMSEs are usually highly embedded in the community, with strong relationships with different groups of stakeholders (Mair and Martì, 2006). The strength of these relationships provides banks with important and structured soft information, and the inclusion of intangibles results in a fundamental strategy. The intrinsic objective of SMSEs to create social value ensures "mission lock", providing comfort to social entrepreneurs and allowing the consideration of social intangibles as collateral (Arena *et al.*, 2018).

Finally, bank credit scoring appears to be a complex issue for SEs because analysing the annual accounts and credit history of a company to assess the default probability is a difficult task. Assessing social impact issues is an additional difficulty, given its non-financial nature. Developing social and financial scoring for SMSEs poses different interesting problems to banks. The first is the kind of information used. An SMSE in general does not have a previous history, and if SEs present themselves as “normal” businesses, their trading profile will present as a high risk. In addition, the inability of SEs to profit from grant funding, thereby inhibiting their ability to generate reserves to strengthen their balance sheet, will also influence the risk assessment. However, we can declare that all credit institutions, even specialized ones, evaluate all social business subjects primarily based on their repayment capacity. This challenge is strictly correlated with the social impact measurement issue, and the international literature emphasizes the importance of identifying models that are able to measure the real social return generated by social organizations (Arena *et al.*, 2016). The lack of formalized and shared measurement systems that support interaction between different players in the social ecosystem is well known. These requirements, which typically focus on measurable social impact, can help overcome the problem of a lack of understanding and potential mission drift by supporting the real achievement of social goals by limiting problems of adverse selection, informational asymmetry and moral hazard. Over the last two years, scientific studies, as well as international organizations, financial institutions, trade associations and even individual companies, have provided numerous measurement models with different characteristics that are more or less suited to the different needs of various actors. The crucial question is how their measurement is translated into practice, who defines them and what effect they have on funded actors. Obviously, much depends on the distribution of the relative bargaining power (Bengo *et al.*, 2016) between the financier and the financed, which will determine not only the level of the goals set on which to base provision but also, above all, the very nature of the components of measurement. The integration of social impact value on credit scoring represents a big challenge to overcome through strong relationships among lending infrastructure, financial structures and lending technologies to allow the composition of the various interests to generate virtuous practices for the entire ecosystem.

Finally, the Italian case shows that the current lending infrastructure must undergo a revision process to support SMSE credit availability, and government policies also affect the national financial institution structure. The relationship between SMSEs and Italian banks is still underdeveloped, and that reduces the feasibility and profitability of the deployment of different lending technologies to fund SMSEs. The regulatory framework from the point of view of the banking system "neglects" the existence of social businesses, and the same social banks are confronted by a standard framework (banking regulations and strict Basel agreements). Given the lack of a clear framework to regulate the demand side, it is difficult to loosen the constraints for social banking.

This represents a set of fundamental suggestions for all actors involved (policy makers, bank managers, social entrepreneurs), and it is an important research question to explore in future studies.

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TABLES

Table 1: Case settings

Banks	Tipology	Support services	Specific initiatives	Task force G8 participation
Aiace	Social bank	- Solutions for daily operations. - Financing. - Investments	Social projects	Yes
Antigone	Specialized bank within a group	- Solutions for daily operations. - Financing - Investments - Guarantee funds - Complementary services/ counselling	Evaluation model for social enterprises and communities.	Yes
Filottete	Cooperative bank	- Solutions for daily operations. - Financing. - Investments - Complementary services/ counselling.	Training course for the nonprofit.	Yes
Edipo	Traditional bank – national	- Solutions for daily operations. - Financing - Investments - Complementary services/ counselling - Solutions dedicated to the people involved in the organizations - Social Bond	Observatory on finance and non-profit	Yes
Elettra	Traditional bank – international	- Solutions for daily operations. - Financing. - Investments	-	Yes

Table 2: Interviewees

Banks	Interviewees
Aiace	- Bank president - Manager of corporate social responsibility
Antigone	- CEO - Head of rating and monitoring - Manager of development financial assets
Filottete	- General director - Head of Development - Non Profit Sector Coordinator
Edipo	- CEO - Non Profit Sector Coordinator
Elettra	- Vice President - Director of Portfolio Management - Managing Director and Head of Investments and Insurances

Table 3: Financial institution structure

BANKS	TIPOLOGY	LOCAL / INTERNATIONAL	N. BRANCHES
Aiace	Social bank	Local	17
Antigone	Specialized banks	International	60/4100
Filottete	Cooperative banks	Local	46
Edipo	Traditional bank	Local	1560
Elettra	Traditional bank	International	550

Table 4: Lending technologies for each bank

Banks	Financial statement lending	Asset-based lending	Relationship lending	Small business credit scoring
Aiace	It has a specific reclassification of the financial statement and it adds the data of tenders or grants	It considers diversified information: governance system, relationship with the stakeholders, on-going contracts	It considers the relationship lending as a guarantee, including information about the rooting and the integrity of a social enterprise on its territory of reference, its affiliation to supporting networks and its good reputation.	It uses a specific credit scoring model developed for SEs
Antigone	It reclassifies according to the guidelines provided by Agency for Third Sector's criteria	It integrates the social intangibles, e.g third parties available	It considers the relationship lending as a guarantee, including information about the rooting and the integrity of a social enterprise on its territory of reference, its affiliation to supporting networks and its good reputation.	It uses a specific credit scoring model developed for SMSEs
Filottete	It adds the information about the prospect client's self-financing through a mix of resources	It adds guarantees linked to the governance, information about the planning and control instruments adopted, quality certifications, ethical charter..	It doesn't take this kind of lending into consideration	It uses different scoring models depending on the financial instruments required by SMSEs
Edipo	It adds the information about the prospect client's self-financing through a mix of resources	It integrates the social intangibles	It considers the relationship lending as a guarantee, including information about the rooting and the integrity of a social enterprise on its territory of reference, its affiliation to	It uses different scoring models depending on the financial instruments required by SMSEs

			supporting networks and its good reputation.	
Elettra	It uses a traditional financial statement	It uses a traditional asset-based lending	It doesn’t take this kind of lending into consideration	It uses the traditional scoring for for-profit enterprises

Annex 1: The interview guide

- How much is your bank active in the social business?
- How long has your bank been active in this sector?
- Why did you choose to enter this sector?
- What forms of financing do you offer to SEs / social business organizations?
- Do you offer additional services?
- How much do SEs / social business organizations weight in your customer portfolio?
- How do these organizations perform compare to other clients?
- What documents / information you used for the evaluation of SEs / social business organizations?
    - Financial statements
    - Collaterals
    - Available Assets
    - Personal guarantees
    - Soft information (eg. relationships)
- How do you evaluate them?
    - What performance dimensions are considered in your evaluation model (example: assets, liquidity, solvency, leverage, etc.)?
    - What indicators are used for each dimension (quantitative / qualitative, examples)?
    - How did you select the indicators?
    - Do different dimensions / indicators have different weights?
- Do you use a specific credit scoring model?