

NEW FORMS OF ETHICAL BANKING FOR AN INCREASING SOCIAL DEMAND : BANCA ETICA (ITALY)

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1. Introduction

Banca Etica is the first alternative bank in Italy. It was constituted (as a bank) in May 1998 and it started banking activities in February 1999.

Some of Banca Etica's key characteristics are:

- To give credit to organisations founded on values such as solidarity, helping the disadvantaged, the conservation and development of the environment and the promotion of enterprise linked to the respect of human rights;
- Strong partnerships with organisations such as third sector enterprises, local authorities, religious associations, environmental associations, trade unions, local committees;
- Strong member participation in the Bank activities, the members being grouped in local volunteers associations (GIT: *Gruppo Iniziativa Territoriale*) to organise promotional activities;
- Assessment and selection of enterprises (or projects) through a set of economic, but also social and environmental criteria which guarantee their ethical qualities.

The following text will give a view on the larger setting in which these specific characteristics are articulated and some tools that help to enact Banca Etica's strategy. In particular, the role of the third sector for Banca Etica, the synergy that can be created with local authorities and the evaluation methodology to finance social enterprises will briefly be reviewed.

2. Welfare state crisis and the role of the Third Sector in Italy

Neither the Government nor the Market seem to be able to give an answer and to provide those services necessary for the improvement of the quality of life, culture and leisure time. This willingness to meet a growing spectrum of unsatisfied needs is one of the reasons that motivated the European Union to support the Third Sector, specifically in view of creating jobs (Third System and employment, working programme of European Commission for employment, industry and society, DGV, 1998).

A large debate about the definition of the Third Sector has been going on for some time, but once again we can use the European definition saying that *the word Third Sector defines whole organisations that belong neither to the public nor to the private for-profit sector* [Ibid].

Third sector organisations are co-operatives, associations, charities, foundations that provide goods and services or develop an economic activity. They differ from traditional enterprises in that profit is not their primary goal. Their private sector framework differentiates them also from the public sector.

The presence of unsatisfied needs and the opportunity to satisfy them through new forms of economic activities, give room for a wide growth of the Third Sector. Several experiences mixing social and economic goals have emerged to satisfy an increasing social demand, and at the same time, have been creating concrete employment opportunities.

The interest for the Third Sector is strong at the level of the European Union institutions. Several interesting programs - mainly concerning employment - reveal the importance of this sector in terms of employment and welfare creation (and also diversity).

Recent analysis (Eurostat, 1996) confirm that the Third System enterprises:

- comprise between 6% to 6.5% of the total number of European private enterprises;
- employ 6.4 million people (5% of total employment) of which 59% are in the association sector, 34% in the co-operative sector, 7% in the mutual sector. The percentages may of course vary from country to country, for example the Third Sector organisations providing social services represent 29% in France, 23% in Germany and 25% in Italy. Moreover, although the number of associations is higher than that of co-operatives, it is the latter that create proportionally more employment (53% of the sector) and higher turnover (79% of the sector).
- have proportionately created more jobs in the '80s than the economy as a whole, i.e. 11%

against 3.7% in Germany, 15.8% against 4.2% in France and 39% against 7.4% in Italy.

Some data on the Italian Third Sector

- 418,000 employees = 1.8% total national employment
- 39% growth rate of employment during the '80s (general growth rate of employment was 7.4%)
- 4,000,000 people engaged in social activities
- 16,000 conscience objectors

- 52,000 social enterprises :
 - 1.1% of GDP
 - 52.7% of public financing (30% contracts, 17.5% grants)
 - 46.7% of private financing (about 32% from selling goods and services)

3. Social demand and Social Investment supply: the birth of Banca Popolare Etica

3.1. Banca Etica: the first social bank in Italy

In 1994, a widespread movement involved in social co-operation and protection of the environment launched the Banca Etica project. The aim was to provide a tangible instrument for a new school of thought for finance and economics. Unions, social co-operatives, local authorities, associations and NGOs (all organisations with strong territorial roots and with a relevant social dimension) participated in this ambitious initiative. They built on the experience of the Mutual Self Management initiatives (MAG) in Italy, and of the alternative banking system in the rest of the world.

In May 1998 the Cooperativa Verso la Banca Etica reached the amount of social capital required by the Italian legal system to become a bank. An extraordinary meeting of the shareholders changed

its statute and its legal framework transforming it from a co-operative structure to a bank (specifically a Banca Popolare). On 8 March 1999 Banca Etica, the first ethical bank in Italy, became completely operational and opened its door to the first customers.

The main products of Banca Etica (on the fund raising side) are ethical certificates of deposit and ethical bonds (in the long term other services may be offered such as a current or savings account, ATM services, etc.). It is also forecasted that the saver will be given to choose the level of interest rate, which he can forego partly or completely to allow for lower interest levels for the enterprises financed.

Banca Etica finances enterprises that develop activities in the following sectors:

- Social co-operation and other social activities
- International solidarity
- The environment
- Culture, civil society and sports

Some figures on Banca Etica

- 7,500,000 Euro of capital stock

- 13,000 shareholders:
 - 1,800 non-profit organisations
 - 169 local authorities
 - 17 banks
 - 11,000 individuals

Internationally, Banca Etica is involved in the development of microcredit, notably through the participation at Microcredit Summit activities and Microcredit programmes carried out by the World

Bank. Banca Etica is also a member of INAISE (the International Association of Investors in the Social Economy).

3.2. The Third Sector as the main market of Banca Etica

Banca Etica is mainly directed towards the market of non-profit enterprises - also called social enterprises¹.

A social enterprise is an organisation able to link management plans with social intervention while operating in a competitive market. It is indeed so that between the market and State, there is an increasing room where this new sector of social enterprises can play a substantial role. Social enterprises promote a fairly new organisation model able to satisfy the increasing social demand, particularly in the social services sector, with the possibility for employment creation.

Some features of social enterprises are:

- Their aim is to maximise social utility. For these enterprises profit is a constraint to respect and not a goal to maximise.
- They achieve this by developing a range of activities such as providing employment opportunities for disadvantaged people, health care, environmental conservation, cultural initiatives, etc.
- The organisational structure is non hierarchical. They promote sharing of responsibility and management among employees, the involvement of customers, and stakeholder participation in general. Moreover, social enterprises can rely on a network of volunteers that promote and support the enterprise's activity.
- Their production activity is based mainly on services and goods with a high social impact. The goods and services produced usually have a low added value. This is due to the high labour costs involved in employing disadvantaged people as well as in the limited economies of scale.
- They have particular legal frameworks, which allow them to provide goods and services in a better way and sometimes to get funding and fiscal advantages.

¹ The Italian case is particular: at the moment Banca Etica is mainly oriented towards providing funding to the non-profit sector. Nevertheless, as occurs at the European level, there are no constraints to extend Banca Etica's activities also to Social Enterprises with a for-profit framework.

The Italian legal framework for Social Enterprises

Social Co-operatives

According to law 381/91, *social* co-operatives have as an objective the pursuit of the general interest and of social integration as :

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|---------|--|
| cat. A) | social health and educational services; |
| cat. B) | agricultural, industrial, commercial or service activities that employ at least 30% of disadvantaged people. |

Associations (ONLUS)

It is the recent reform act on the non-profit system that rules the association status. Associations are defined as social voluntary organisations that do not have for-profit goals. They have to pursue a non-economic objective (art.12-42 cod. civ.). They can be instituted e.g. for sports, culture, natural conservation.

Co-operatives

Co-operatives in general can also be considered to fall within Banca Etica's target group, on the basis of their mutual goals - which is their main distinguishing characteristic from ordinary companies according to the Italian legislation. Co-operative activities have to consist in providing goods, services and employment directly to members of the organisation at more advantageous conditions than those prevailing on the market. Several kinds of co-operatives are covered by the Italian law, ranging from production activities (agriculture, industry, handcrafting, etc.) to service activities. An important particularity is the limitations falling on profits, which may only be distributed in proportion with the legal interest rate (art. 1026 Civil code, law 31 January 1992, n.59).

4. A new model of Welfare Finance: some projects of collaboration between Banca Etica and Local Authorities

Among the partnerships that Banca Etica developed with a range of different organisations (see pag.1), the collaboration with Local Authorities is particularly interesting.

The policy of Banca Etica is oriented towards a mixed welfare society where the public sector collaborates with the third sector. In practice, collaboration with a decentralised administration does not always guarantee participation. Yet Banca Etica wants to promote horizontal (non hierarchical) subsidiarity, which means full participation between citizens, social organisations and local authorities in the decision making process. In a context of welfare state crisis, public and third sector organisations have a mutual interest in cooperating. The third sector is able to produce a high level of social welfare and to substitute itself in part for the public administration in providing social services.

However there are some difficulties for local authorities to get involved with the Third Sector. Firstly, local authorities often do not know much about the third sector, be in terms of its dimensions, its structures, or its mere presence on the territory. Secondly there is a lack of standard tools to evaluate the capacity and social efficiency

of the delivered social services. Thirdly, there is no appropriate legislation for regulation of the Third Sector.

Banca Etica can represent an interesting link between Local Authorities and the Third Sector. Presently, 6 Regions and 190 Municipalities are shareholders of Banca Etica and have underwritten about 800.000 Euros of its capital stock, thereby creating a strategic partnership to be developed through common tools :

Cash advances :

Banca Etica will for instance finance social enterprises which receive funding from public institutions (such as the European Union, Italian Government, Regions, etc.). Because of bureaucratic reasons, public support is often late and social enterprises often risk to go bankrupt in consequence.

Stock capital for Social Enterprises (Cooperative di Capitalizzazione) :

Under-capitalisation is a structural problem among Social Enterprises, in particular among those involving disadvantaged people in their production process (type B co-operatives). The lack of stock capital is one of the main causes of difficulty in accessing credit, which is why a new organisation, a capitalisation co-operative (*cooperative di capitalizzazione*) will be set up. Local authorities, Banca Etica and other stakeholders will provide

the needed capital, with the Local Authorities (and Regions) as the main shareholder.

Banca Etica's role and competence in collecting the funds for the *capitalisation co-operative* is an important one, as it will carry out a territorial campaign to collect stock capital and donations - similar to the 3 year campaign it carried out to collect its own capital. This mobilises a strong network of social co-operatives, families, volunteer associations, trade unions, churches and individuals.

Banca Etica will also assist the capitalised social co-operatives in assessing their financial needs, will help them implement their business plan and will complement the capital with short and medium term credit on a one to one basis.

Municipal bonds (Buoni Ordinari Comunali, BOC) :

Municipal bonds are a new financial tool in Italy to collect funds from citizens for public projects. Banca Etica will orient local authorities in choosing projects of common interest. In a context of welfare state privatisation, it is indeed important that the new partnerships be set up strategically to serve and respect the most disadvantaged people. Ethical Finance as understood by Banca Etica, working across the full range of partners from welfare state to social organisations, must play a significant role in those upcoming scenarios.

5. New criteria for enterprise assessment

Banca Etica's way of selecting enterprises worthy of funding is one of the features that makes it unique in the Italian banking context. It is interesting to describe the principles employed by Banca Etica in its investigation process.

The main goal of Banca Etica is to provide credit to economically reliable enterprises that demonstrate attention to the social utility they produce. In addition to standard economic analysis, Banca Etica analyses the consequences that different production activities can have on human health, public welfare and the environment. This means that the Banca Etica staff needs new

tools to investigate values that have not been examined so far by the existing banking system. The objective is to work towards a system of indexing and parameters that must eventually be as objective and clear as possible.

5.1. Social and Environmental Evaluation of Social Enterprises (the VARI model)

Banca Etica has created an innovative assessment tool, the VARI model (Values-Requisites Indicators), to evaluate social enterprises. The assessment of credit demand, from an ethical finance point of view, must and can be based on a relatively simple system, to provide a tool that must be easily usable both by the bank staff and the credit applicant. It must be simple also because it adds an ethical assessment to the economic analysis. Moreover, as well as being a formidable instrument for Banca Etica to achieve its social mission, it can also be so more generally for the financial instruments of the social economy.

The VARI (Values Requisites and Indicators) method developed by Banca Etica mainly refers to social-environmental aspects. It is a simple tool that allows the bank staff to have wider information on the investigated enterprises. It allows to consider the whole project, the coherence with its mission, its structure and its long term soundness. The valuation model VARI (Values Requisites Indicators) requires two essential steps:

① First, each funding request must be preceded by an application-form in which the enterprise is described in its essential lines (type of organisation, human resources framework, main activities, further economical information). It is at this stage also required to pass the admission threshold (negative criteria) under which the ethical financing can't be granted. Banca Etica will refuse to finance all enterprises whose activities are in opposition with its scope. For this reason each enterprise or association will provide a self-certification document confirming the adherence to some minimum criteria and declaring that it has not been involved in a series of negatively defined activities (see box)

The Admissibility Threshold: Exclusion Criteria

Banca Etica will exclude all the enterprises that produce:

- Health hazardous products (such as genetically modified plants and food).
- Environmental hazard and exploitation (pollution; intensive exploitation of soil, underground and natural resources; animal experimentation; nuclear energy production; highly energy consumption activities).
- Lack of respect for the human dignity (abuse and discrimination of workers; no guarantees on health and safety in the work place; sexual, religious, political discrimination; pornography, drugs, alcohol, tobacco, gambling).
- Abusive political relationships (direct or indirect links with dictatorships; economic activity for political interests or viceversa).
- Shipping industry.

⑨ The second step, after passing the admissibility threshold, is then to proceed with the valuation based on the VARI model as such. This model is based on 9 basic "Values" which are of importance to Banca Etica and to which the loan applicant must demonstrate respect to. For each value there are some essential "Requisites" that guarantee the respect of those values. For each requisite a set of "Indicators" have been identified to see whether the requisites are respected.

For example the indicator "*Number of women present on the board of directors*", is one of several indicators that identifies the fulfilment of the essential requisite "*No gender discrimination*". This requisite is one of those referring to the value "*Equal Opportunity*", the respect of the requisite could mean the fulfilment of the value. Another example is the indicator "*Periodical pollution control*" that refers to the requisite "*Respect of the environment*", that is one of the requisites belonging to the value "*Eco-sustainability*".

5.2. *The evaluation quadrants: a "political problem"?*

One of the problems of such an investigation system is the correct balance between economic and social-environmental valuation and, inside the VARI system, the weight given to each single value and its indicators.

In particular, it is important to establish, looking at fig.1, in which quadrant the Social Enterprise is situated in. While quadrant I represents an optimal valuation (economic and social-environmental valuation are both positive), quadrant III represents a totally negative valuation, and thus the impossibility to provide any financing.

Quadrant II and IV constitute the real problematic knots, with situations that are neither totally positive nor negative: in one case (quadrant II) there is positive economic evaluation and a negative social-environmental one, in the other one (quadrant IV) the social-environmental valuation is positive while the economic one is insufficient.

In these two cases, it will be necessary to take actions to reward the "orientations" that lead from quadrants II and IV to quadrant I.

Figure I: Evaluation quadrant

Social / Environmental

IV

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I

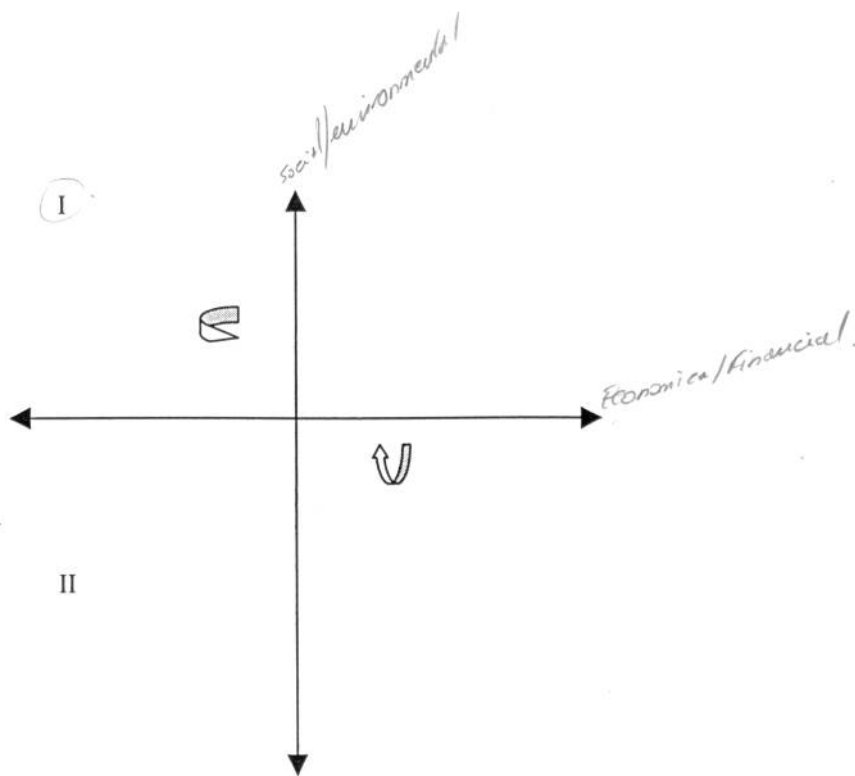
Economical / Financial

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III

II



To conclude, as a pioneering ethical bank in Italy, Banca Etica explores new ground in a) the extent of its partnerships with regional government, local government and the third system and b) the efforts it makes to clearly assess the social and environmental impact of its lending decisions.