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MAKING ACCESS TO CREDIT MORE DEMOCRATIC: TOOLS AND PRACTICES BETWEEN SOCIAL INNOVATION AND OLD INEQUALITIES

Valentina Moiso

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Making access to credit more democratic: tools and practices between social innovation and old inequalities*

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ABSTRACT: The economic crisis highlights the problem of access to credit also from the point of view of families. The Italian banking industry has launched projects aimed at offering financial support to disadvantaged people, implementing new products for certain categories of customers normally excluded from credit due to the high risks involved. The information collected about each customer is an input in the decision-making process. Hence, it is crucial to investigate how it is selected, how it is (re)assembled, and how it is evaluated. Understanding how information about a customer is selected and processed helps us to identify what resources owned by households are translated into a positive score to access credit and into opportunities to enjoy additional goods and services, thus reconfiguring the trends of inclusion and exclusion within the financial system.

KEYWORDS: access to credit, risk evaluation, peer to peer lending, financial and social innovation.

JEL CODES: G1, I39, D14, Z13

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CONTENTS

1. INTRODUCTION

This paper analyzes the process of customer assessment for access to credit in relation to four different financial intermediaries operating in Italy: a commercial bank, a credit cooperative bank, a MAG – mutual self-management – and a *peer to peer* lending institution. The focus is on families applying for a loan and on how the institutions under investigation elaborate indicators to assess the risk of insolvency of said families – the factor according to which they decide whether to grant or deny loans and at what price. Our research looks into credit granting practices, since studying the type of information gathered and how it is processed sheds light on which types of families are deemed *worthy* of accessing credit, regardless of any claims about the uniformity of *financial democratization*. Moreover, we also analyze how the profile of worthy families changes depending on the mission of the financial institution considered, with major consequences in terms of equal opportunities.

The involvement of families in the financial markets has appeared in the sociological debate only recently (Swedberg 2005; Hoffman *et al.* 2007). Yet, this issue takes on great relevance if analyzed in relation to one of the key aspects of today's heavily finance-based economy, i.e. resorting more and more often to financial resources, in particular going into debt, to meet family demands (Warren and Warren 2003).

The subjects affected by this phenomenon are above all actors who are «neither rich nor poor», as Goodin and Le Grand (1995) define individuals belonging to the middle class who possess tangible assets which are, however, insufficient to meet all their needs. As a consequence, they are highly knowledgeable and proficient users of public services since, thanks to their cultural capital, they can deal with the bureaucracy needed to access said services, especially for what concerns education and healthcare. On the other hand – and this dimension has so far not been thoroughly investigated in the literature –, they turn to the financial system to increase their wealth by investing in shares or to borrow money. Indeed, although their tangible assets are not enough to meet all their needs (for instance, to buy a new home), these represent a good type of collateral allowing access to rather large amounts of credit depending on the wealth possessed. Nevertheless, middle class individuals are not as skilled in dealing with the financial system as they are in using public services. Hence, they gather information and make decisions under conditions of great uncertainty, and their access to financial services is determined and mediated by the system's *access points*, i.e. financial intermediaries.

The decision to go into debt, just like in the case of public service use, often has the aim to preserve *suitable* living standards or, more precisely, to provide support at key moments in an individual's transition to adult life, such as completing one's education, setting up a new business, purchasing one's first home, and having a child. Within a framework of growing inequalities in the distribution of wealth, access to financial capital plays an increasingly crucial role, above all for the younger generations. Therefore, studying access opportunities – in relation to wealth already owned, cultural and economic assets linked to one's profession and family of origin, as well as social networks and available social capital – means investigating one of the new axes of inequality, also taking into account its perpetuation across different generations (Crompton 1998; Carruthers 2005).

The Italian banking industry has launched projects aimed at offering financial support to families, implementing new products to increase their access to credit. The banks pursue this type of "financial democratization" in collaboration with non-profit actors and they devise new products and processes to assess and manage situations not usually evaluated in the past. However, is it possible to interpret these projects as cases of direct innovation to meet social needs, a true example of social innovation?

The paper is organized as follows: we introduce the topic, the tools, and the practices used to make access to credit "more democratic" in different institutions; then, we illustrate the research and describe the *gathering* and *evaluation of information* about a customer's credit worthiness in the four institutions considered in this research.

2. THE GATHERING AND EVALUATION OF INFORMATION ABOUT A CUSTOMER'S CREDIT WORTHINESS

Expanding access to credit is becoming a key objective in the banks' core business, but the increasing number of individuals who apply for a loan requires risk management of new types of customers-borrowers.

In implementing the above-mentioned financial democratization processes, the Italian banking system has been following some general macro-trends which are characteristic of Western capitalism. The first trend regards the use of technology, which has opened up new opportunities for banking institutions in the procedures for offering credit, especially for what concerns the ability to manage large databases. Each institution can create, store, update, and process the electronic profiles of its customers, also in order to address its promotions to specific target groups. Customers are managed by means of increasingly standardized and computerized procedures (Customer Relationship Management), in which branch operators represent just «the last links of the chain», i.e. the interface with the customers. Furthermore, historical data on customers' debt are collected by third-party agencies, which put together and organize large databases, shared among the intermediaries in order to calculate, by means of mathematical models, the insolvency risk of debtors based on their past behavior and current situation (rating). Sophisticated algorithms integrate the risk rating with statistical information on the average insolvency risk of the socio-economic reference group to which the debtor belongs (credit scoring). This procedure enables banks to break up their clientele into segments, thus diversifying their offer by creating a series of mortgage products with different costs and parameters depending on the customers' risk scores. This product and process standardization is believed to make the management of banks more effective and efficient, and it is legitimized in the name of creating more value for the shareholders, according to the principle stating that an enterprise – hence, also a bank – is the property of its owners, which actually creates an imbalance of power in favor of the shareholders and to the detriment of the stakeholders (Dore 2008).

Therefore, new technologies are adopted in order to standardize practices, and to gather, organize and use information about customers. Said information concerns a customer's credit history and characteristics, such as socio-demographic data, wealth (individual and family), ability to produce income, social capital and project(s) to be funded. Information about each customer is then processed and *translated* into a customer's credit worthiness indicator; the evaluation of this indicator enables an intermediary to make a decision about access to credit (Fig. 1).

The information collected about each customer is an input in the decision-making process. Hence, it is crucial to investigate:

- how it is selected,
- how it is (re) assembled
- how it is evaluated.

Understanding how information about a customer is selected and processed helps us to identify what resources owned by households are translated into a positive score to access credit and into opportunities to enjoy additional goods and services, thus reconfiguring the trends of inclusion and exclusion within the financial system.

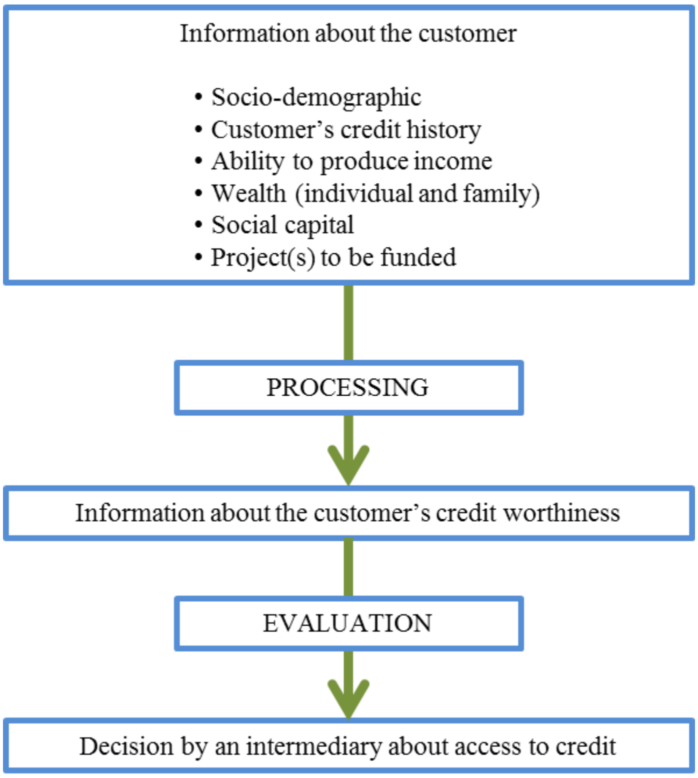

Fig. 1 The customer's credit worthiness indicator: decision-making process

3. THE RESEARCH

A rating system comprises all the elements which play a role in the assessment process, including the definition of insolvency adopted, the methodology to evaluate the risk underlying the exposure, the responsibility of those managing the system, and the way in which the information provided by the rating is used.

In this article, the evaluation and understanding of customers is analyzed as the result of a situated interaction involving the customer, the branch operator, and the technology used in order to perform the assessment (see also Dufy et Weber 2007). Therefore, we refer to the literature on workplace studies focusing on work practices mediated by technology: *technology* is the set of instruments (or devices) available to and used by skilled operators (Callon *et al*. 2007). In particular, we look at the application of this approach to the analysis of financial exchanges, recently developed within the so-called Social Studies of Finance (Knorr Cetina and Preda 2005; Preda 2007; Godechot 2009; Moiso 2011). This approach places work practices within the social and material context in which they take shape, considering the relations between human actors and devices in work settings.

These settings are technologically dense: the daily interaction among colleagues can lead to the diffusion of organizational devices and documents, such as reports, analyses and newsletters to refer to how operations are implemented (Preda 2002).

The operator is socialized in a certain way of doing risk assessment.

This paper analytically identifies two ideal types of approach: social evaluation and credit scoring. Each case requires the operator to be highly skilled and to know how to handle special techniques, which, however, differ in their degree of procedure automation.

In the case of social evaluation of risk, the operators have to construct a dense network of relationships in order to gain access to information not otherwise obtainable through a purely professional relationship (Ferrary 2003).

This is not necessarily a "primitive" and inefficient approach and it can make up for the limits of scientific methods and institutional tools.

The information required for the evaluation is acquired through the creation of informal networks based on trust between the operator and the customer.

The extent to which information asymmetry is reduced depends on the quality of the social capital owned by the operator, particularly given the degree of its integration into the relational and economic fabric to which those who apply for a loan belong.

This strategy is very time consuming and, therefore, expensive; hence, banks may tend to avoid it if the system allows them to implement rating and credit scoring techniques (Moro and Howorth 2009).

Rating techniques provide a quantitative index of the risk score in the present, whereas credit scoring provides a forecast of insolvency risk in the future. An algorithm translating the characteristics of the customer into a score automatically calculates both and, in the case of credit scoring, the score is combined with the average data of the social group to which the customer belongs.

The transition from social evaluation – involving a relationship based on trust between the operator representing the bank and the customer – to credit scoring can be seen as a shift from personal to systemic trust: a bank lends money because it is protected by law (for example, in the case of loans, with a collateral mortgage) and because it trusts in automated management (Lacan *et al.* 2009). The system is based on credit scoring and, consequently, market growth cannot be achieved solely by using social evaluation.

The supposed objectivity of quantitative techniques implies a normative idea of the optimal customer, i.e. the so-called *excellent payer*.

However, this depends on which of the customer's resources are rewarded in the elaboration of the score for the purpose of risk calculation (see Lazarus 2009).

In relation to the matter at hand, the Italian banking sector displays some peculiar characteristics, in particular the coexistence of very different organizations: from commercial banks with a high degree of standardization to smaller institutions with a strong local dimension, which assess their customers socially. The latter play an important role in maintaining contacts with families and businesses, while larger banks engage mainly in reorganizations, mergers and acquisitions.

This research compares two experiences in the banking sector, a traditional bank and a credit cooperative bank, with two projects having the goal of reconfiguring the means of access to credit: a technologically innovative project, that is *peer to peer lending*, and an initiative which has its roots in the financial democratization movements of the 1960s, that is a *cooperative for mutual self-finance (MAG)* stably operating in Italy.

It is particularly interesting to determine whether the supposed innovation of these approaches is accompanied by substantial differences in the evaluation of customers.

We conducted four ethnographic case studies, with 46 in-depth interviews with the operators. The ethnographic case studies and interviews were carried out in the two banks over a period of 12 months, while the investigation of the social lending project (*peer to peer*) and of *MAG – Mutual self-management* lasted for 6 months. The in-depth interviews were conducted with operators in bank branches or at the headquarters (p2p and MAG), with those responsible for product development, as well as with executives – bank managers, the p2p CEO, and the MAG President.

4. THE DECISION-MAKING PROCESS IN THE FOUR INSTITUTIONS

The first step in the assessment of risk involves interacting with the customer – in the branches or on-line – in order to collect the necessary information on his/her social and economic resources.

Subsequently, the data thus collected are translated into an indicator concerning the risk of insolvency.

In carrying out these activities, bank operators use more or less technologically advanced tools, combining score calculation with a less codified and not machine-based assessment.

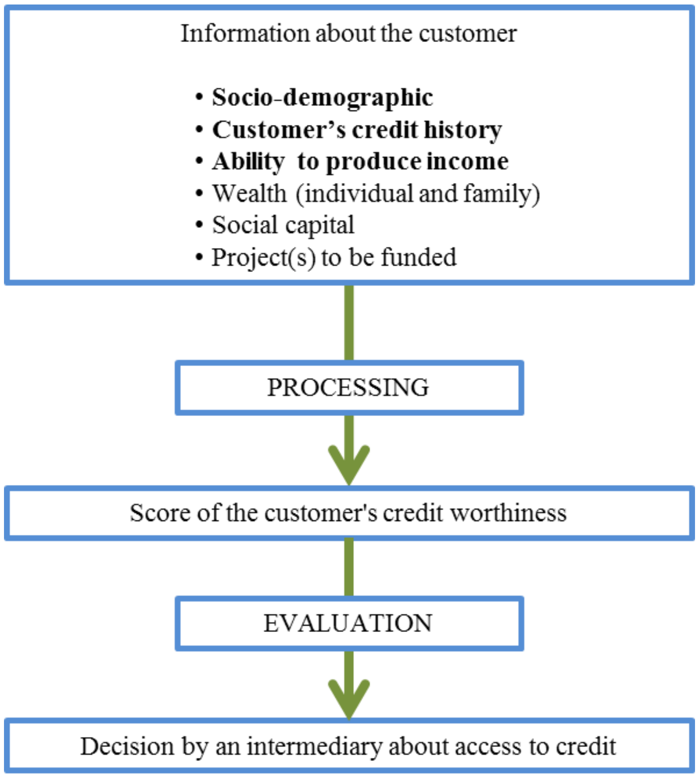

Fig. 2 The customer's credit worthiness indicator: decision-making process in a commercial bank

The information is collected in two ways:

- a survey of each customer, conducted in the branch or on-line;
- consultation of data collected by CRIF and by the Italian Central Credit Register.

The information is processed using an internal rating model.

The result is a score, also parameterised by the average insolvency of the social group to which the customer belongs.

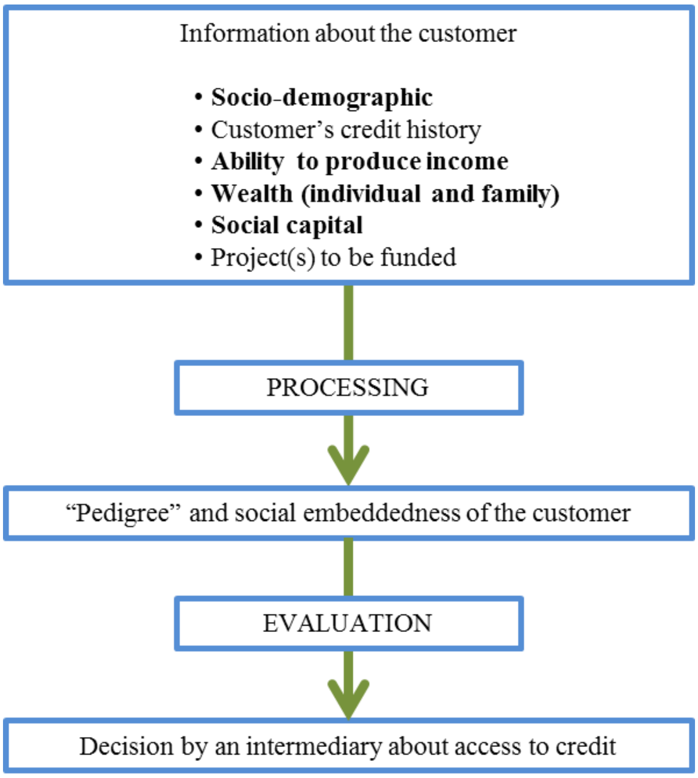

Fig. 3 The customer's credit worthiness indicator: decision-making processs in a cooperative bank

The information is collected in two ways:

- In-depth interviews between the operator and the customer
- Data from CRIF - Italian Central Credit Register

The information is processed using social evaluation.

The result is the elaboration of the customer's "Albero genealogico" (a sort of track record, which we figuratively call "pedigree") and an evaluation of his/her economic-social embeddedness.

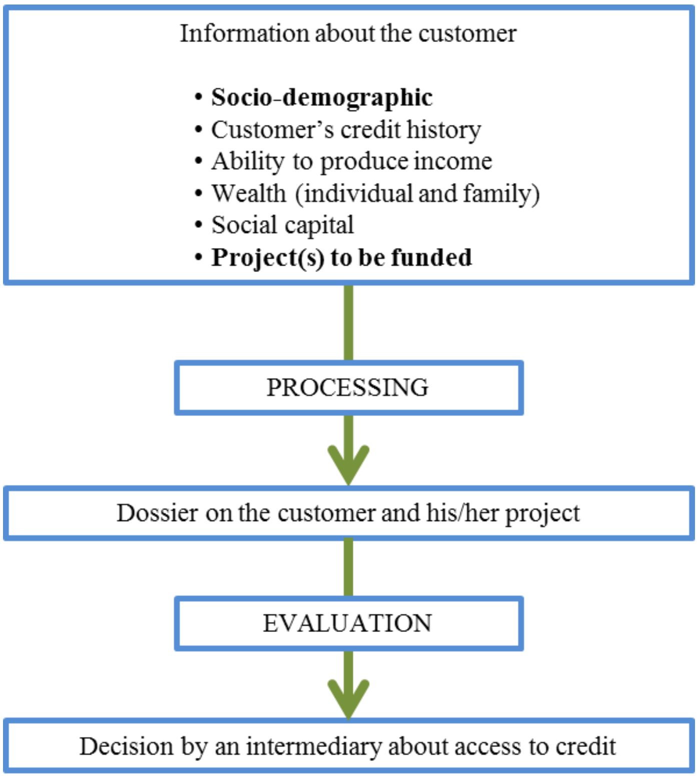

Fig. 4 The customer's credit worthiness indicator: decision-making process in the case of social lending (peer to peer)

The information is collected in three ways:

- Filling in of an on-line form
- Data exchange via e-mail
- Data from CRIF - Italian Central Credit Register

The information is processed using an internal rating model.

The result is a dossier including the customer's score and a description of his/her project(s) and motivations.

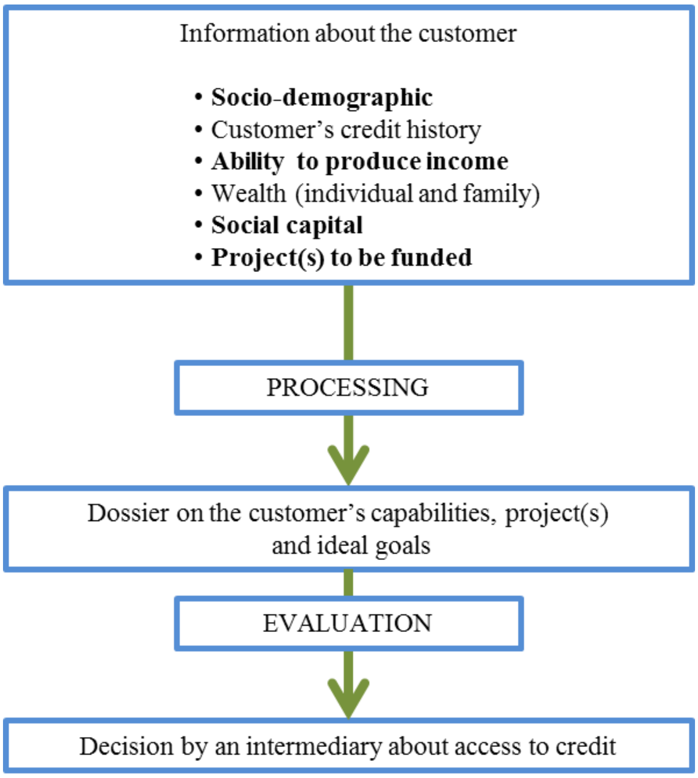

Fig. 5 The customer's credit worthiness indicator: decision-making process in the MAG

The information is collected by means of in-depth interviews between the operator and the customer.

The information is processed using social evaluation by building a strong relationship.

The result is a dossier about the customer and the possibility of offering support and financial consulting.

Tab. 1. Standard process for customer assessment/internal rating systems: actors, tools, and context

	ACTORS	TOOLS			CONTEXT
	Human and non-human	*Main inputs*	*Processing method*	*Main outputs*	*Doxa**
COMMERCIAL BANK	-Front office operators -IT system (automated data elaboration)	-Standard questionnaire for automated data collection -Credit Register Data	Internal rating model	Scoring, rating	Average risk of the reference social group
CREDIT COOPERATIVE BANK	-Front office operators -IT system (automated data management)	-Data collection interview with paper and pen -Credit Register Data	Social assessment	“Pedigree”	Socio-economic embeddedness
P2P	-Back office operators -IT system (Internet) -CEO	-On-line introductory dossier -Credit Register Data	-Internal rating model -Social assessment	-Scoring -Project(s) assessment	Innovation, determination, energy…
MAG	-Operators-consultants -IT system (computer)	In-depth interviews	-Social assessment -Strong relationship	Dossier	Degree of opposition to the economic system

*The characteristics forming the basis of correct risk assessment according to the view commonly accepted and legitimized within the enterprise.

The results highlight key differences in the decision-making process of the four subjects, among which, for example, the use of internal rating models or social evaluation, or the use of credit register data or in-depth interviews between the operator and the customer. We have compared the single phases of the process and its outcome, i.e. a *score* for the commercial bank, a *“pedigree”* (track record) for the cooperative bank and a *dossier* for the p2p and MAG.

The output is the same for the latter two institutions, which present themselves as socially innovative and pursuing financial democratization, but the processes used to elaborate the dossier are very different. The p2p uses the same methods as large commercial banks, since it assesses its customers without any face-to-face meetings and by establishing a solely virtual relationship, entirely mediated by technology; it would be impossible for the p2p to apply social evaluation. In the evaluation process, however, this institution places more emphasis on the customer's characteristics which might be appealing for funding by peers. The final decision is not standardized but it is based on the intuition and experience of a team which analyses all the applications, led by the CEO.

5. CONCLUSIONS

This research compares two experiences in the banking sector, a traditional bank and a credit cooperative bank, with two projects having the goal of reconfiguring the means of access to credit: a technologically innovative project, that is *peer to peer lending*, and an initiative which has its roots in the financial democratization movements of the 1960s, that is a *cooperative for mutual self-finance (MAG)* stably operating in Italy. We conducted four ethnographic case studies, with 46 in-depth interviews with the operators.

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The process of gathering, processing, and assessing social information entirely depends on the profile considered worthy of access to credit, promoted by the decision-makers: a customer rated as being at low risk of default based on standardized credit scoring techniques; a customer with a "good pedigree" (track record); a customer with good or average score who presents a project capable of persuading the CEO and potentially peers via the Internet; or a customer refused by banks but with a project relating to alternative economy which is worthy of support in order to "undermine" the system.

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