

Responsible Finance: Submission to Danny Kruger MP

22nd July 2020

About Responsible Finance

Responsible Finance is the trade body for Community Development Finance Institutions (CDFIs). CDFIs are social enterprises that offer loans and support to viable micro, small and medium sized enterprises (SMEs), social enterprises and individuals in deprived and underserved communities that are unable to access finance – or to do so at a fair rate – from mainstream lenders.

In 2019, the CDFI sector lent almost £200 million to 40,000 businesses, social enterprises and individuals. Of this:

- £78 million was lent to over 4,200 businesses, creating over 3,000 new businesses, 6,000 new jobs, and protecting over 2,000 existing jobs. 93% of the viable businesses CDFIs lent to were previously declined by a mainstream bank.
- £93 million was lent to almost 400 social enterprises, creating 38 new social enterprises, 800 new jobs, and protecting almost 5,000 existing jobs.
- £27 million was lent in 35,000 loans to individuals and homeowners, saving them £7.5 million in interest payments compared to if they had gone to a high-cost credit provider¹.

Responsible Finance's mission is to support the development of a thriving and sustainable responsible finance industry that provides finance for underserved communities and, as a result, contributes to their increasing wellbeing and prosperity.

About our Submission

The CDFI sector is vital to the UK's recovery from the COVID-19 pandemic and the levelling up agenda.

Enterprise lending CDFIs lend to SMEs that have fallen through the cracks, to help them to protect and create jobs, boost productivity, foster inclusive growth and facilitate enterprise creation. They are key strategic partners for the government and the British Business Bank, delivering the Coronavirus Business Interruption Loan Scheme (CBILS), the essential Start Up Loan scheme, and the Northern Powerhouse, Midlands Engine and Cornwall and Isles of Scilly Investment Funds, which each address structural regional imbalances through their expertise and specialised nature.

Seventeen enterprise lending CDFIs are accredited to deliver the CBILS. As of the 20th July 2020, CDFIs have approved over £26 million to 400 SMEs in CBILS-backed loans, and through this protected over 3,000 jobs. They have stepped up their lending by 250% compared to the same period in 2019.

Social enterprise lending CDFIs provide finance and support to charities and social enterprises that often struggle to access appropriate finance. As social enterprises themselves, CDFIs understand the funding and operational needs of non-profit organisations. Social enterprise lending CDFIs are instrumental to the recovery from COVID-19 through the provision of financial support to help charities and social enterprises adapt to the new normal.

¹ Responsible Finance, The Industry in 2019.

Throughout the COVID-19 crisis, because of practicalities, many organisations were unable to access the government's support programmes. Social investors, including social enterprise lending CDFIs, have stepped up to deliver a significant level of funding to charities and social enterprises. This funding includes the [Resilience and Recovery Loan Fund](#), a fund targeted at organisations improving people's lives across the UK who are experiencing disruption as a result of COVID-19, and the [Social Enterprise Support Fund](#), which provides grants to support social enterprises during COVID-19.

Personal lending CDFIs provide affordable loans, money management and budgeting advice to households excluded from mainstream finance. They help people to avoid exploitative, high cost and illegal credit providers, while improving the long-term financial wellbeing of their customers. Since the onset of the COVID-19 crisis, millions more UK people have become financially vulnerable. CDFIs' proactive and innovative response has been a lifeline for people facing financial hardship.

Through this work, CDFIs have shown exceptional innovation, flexibility and can-do spirit as social enterprises responding to the crisis.

This submission begins with a demonstration of the importance of the CDFI sector in the UK's recovery from the COVID-19 crisis and the government's levelling up agenda. This is followed by a recommendation for the government to support access to a £100 million fund for the enterprise lending CDFI sector. Banks are a natural partner to the CDFI sector and are well-placed to channel funding into it, however at this stage an incentive from the government is the most effective way of compelling this partnership. This will allow the government to maximise the role of the CDFI sector.

This submission also contains two appendices of case studies from CDFIs, demonstrating their work since the onset of the COVID-19 crisis.

CDFIs Support Businesses and Prevent Unemployment

There are very few lenders outside of the CDFI space which would consider supporting the borrower profile that CDFIs serve, so if a CDFI does not step in then the business will likely fail. Mainstream banks find it difficult and costly to adequately assess the risk of small businesses that have a thin credit history or a limited trading track record. Many therefore do not have the risk appetite to lend unsecured on flexible terms to businesses which lack sufficient collateral. This is supported by data: 75% of SME applicants for finance were successful but rejection rates were higher for loans (37%), first time applicants (31%) and micro businesses (30%) in the 18 months to Q4 2019. Most of those declined said that it had some adverse impact on their business (69%)².

CDFIs are able to lend to these businesses because, as social enterprises themselves, they are driven by their mission to create local social, economic and environmental benefit. They take a flexible, person-centred approach, and more in-depth processes for assessing business loan applications than other lenders. They can unravel a business's situation to arrive at a 'yes' where a bank's automated credit systems have said no. Despite this additional analysis, CDFIs are charging less loan interest than a number of alternative SME lenders which are accredited under CBILS. This is because CDFIs are not-for-private-profit social enterprises and are therefore motivated by their mission to support local economies, rather than maximising profit from their lending. Any profits they do make are reinvested back into the CDFI to support more businesses and social enterprises.

² BVA BDRC SME Finance Monitor (2020) Q4 2019.

After the 2008 financial crisis, banks retreated from lending to the SME market: reducing lending by £151 billion between 2008 and 2011³. Without incentives such as CBILS and the Bounce Back Loan scheme banks will again retreat from the small business market. When this does happen, the UK's pipeline of investible businesses must have alternative, affordable and appropriate sources of finance available to them.

CDFIs Facilitate the Creation of New Businesses and Jobs

CDFIs deliver the Government's Start-Up Loan scheme. They have seen an uplift in demand in recent weeks as people begin to think about their aspirations after lockdown. CDFIs provide support alongside finance, helping the unemployed transition into meaningful employment.

CDFIs and the Transition to Net Zero

CDFIs are well placed to support the Government in reducing carbon emissions. There are hundreds of community projects, sustainable businesses and social enterprises across the UK making a positive environmental impact which would not exist without community development finance institutions. Some CDFIs also have dedicated funds for community energy projects which enable communities to build successful renewable energy schemes. CDFIs have a track record of measuring the impact of their lending, including environmental impact. Some already offer impact discounting on loan interest for SMEs which agree to adopt measures to reduce their carbon footprint, or for SMEs who are borrowing for environmental initiatives.

The phase out of high-carbon sectors must not leave workers and communities behind. It should promote local regeneration in affected communities and invest in reskilling for workers, and ensure that the transition delivers positive effects for communities. CDFIs help this by creating decent jobs and thriving businesses in deprived areas. This stimulates local economic activity, tackles inequality, and promotes inclusive growth.

CDFIs Boost Productivity

Business investment is a key driver of productivity, and the decline of investment as a proportion of domestic output in the past three decades has had an impact on the UK's low productivity⁴. Data from prior to the COVID-19 crisis, including the SME finance monitor, shows that permanent nonborrowers are less likely to export than those that use external finance, and are less likely to grow, innovate, and make a profit. This contributes to the productivity challenge as businesses are unable to invest in the new equipment and technology which drives up their performance. This ultimately has an impact on the strength and resilience of local economies and the economic opportunities for their residents. Improving productivity is vital for increasing economic growth and raising living standards.

Following the COVID-19 crisis, catalysing productivity growth will be key to the economic recovery. This will be driven by investment and making sure that investment is put to work. SMEs should be actively encouraged to invest in themselves and therefore must have access to appropriate forms of finance.

³ Henry, N. & Craig, P. (2013) Mind the Finance Gap: Evidencing Demand for Community Finance

⁴ Civitas (2018) Closing the Finance Gap.

CDFIs Foster Inclusive Growth and Level Up Pockets of Deprivation

Whilst 94% of CDFI loans in 2019 were made outside London and the South East, CDFIs target pockets of deprivation that exist all over the UK and lend to businesses which will make significant employment impact. 59% of CDFI loans are made to businesses located in the UK's 35% most disadvantaged areas, 42% are made to women-led businesses and 15% are made to Black, Asian and Minority Ethnic-led businesses. Because the businesses CDFIs lend to are located in the more deprived areas and communities of the country, the jobs retained have a multiplier effect on sustaining the local economy.

CDFIs Promote Financial Stability and Resilience in Individuals

Since the onset of the COVID-19 lockdown, there has been a reduction in demand for personal loans because of a reluctance to take on new loans and a decrease in consumption. Despite this, personal lending CDFIs' proactive and innovative response has been a lifeline for people facing financial hardship.

In 2019, 48% of CDFI customers were unemployed. The sector has experience working with people through income shocks to maintain resilience and bounce back faster. The sector also disproportionately serves women - in 2019 65% of loans were made to women – and the COVID-19 crisis has disproportionately affected women.

Looking ahead to the economic recovery there are increased concerns about long-term unemployment. The CDFI sector is keen to reach more people to provide the support needed to avoid reliance on high cost credit and over-indebtedness as people look to bridge income gaps. Knowing the impact that over-indebtedness and financial stress has on mental and physical health, the sector plays a key role in helping people maintain financial resilience, so they face fewer barriers getting back into work or starting their own business. A case study of how CDFIs build this resilience through affordable credit and wraparound support can be found in Appendix 2.

Recommendation

The following recommendation will allow the government to maximise the role of enterprise lending CDFIs both in the recovery and in the government's levelling up agenda.

- **The enterprise lending CDFI sector needs access to £100 million of low-cost funding to enable it to continue its CBILS-backed lending and step-up its support for SMEs through the recovery.**

CDFIs and non-bank lenders are not on a level playing field with banks as they do not have access to the same low-cost capital. If left uncorrected, this unlevel playing field risks damaging the long-term sustainability of the non-bank finance sector, and creating a less diverse financial services ecosystem. Based on previous funding programmes, the government could protect 13,000 UK jobs by unlocking a £100 million fund for the CDFI sector.

A long-term solution for channelling funding into the CDFI sector is through partnering with the mainstream banks. However, at this stage an incentive from the government is the most effective way of compelling the banks to partner with CDFIs.

Appendix 1: Enterprise Lending CBILS Case Study

Virtuoso Legal, supported by



Virtuoso Legal, a world class intellectual property solicitor practice, continues to trade confidently through the COVID-19 pandemic following a CBILS-backed loan from NPIF – BEF & FFE Microfinance, which is part of the Northern Powerhouse Investment Fund.

The Leeds-based company was founded by Liz Ward, a highly experienced intellectual property solicitor, in 2007. At the time it was one of the first dedicated intellectual property specialist firms in the UK. Today it employs 16 staff, has turnover of £1.3m and delivers commercial intellectual property advice to clients across the UK and beyond.

Virtuoso Legal approached BEF via independent commercial finance brokers, Redsky, after it recorded a downturn in sales due to the current COVID-19 pandemic. Virtuoso Legal have used the loan to improve online visibility and create new content and ideas for marketing. The money has also been spent on SEO for the website and improving leads via Click Funnels marketing. The overall upturn in instructions has been excellent.

Elizabeth Ward, Founder and Principal of Virtuoso Legal, said *“As always, Mark and the BEF team have been brilliant. The support from BEF has enabled us to respond positively to the challenges posed by the coronavirus pandemic. We have seen an upturn in sales due to a surge in innovation that businesses are keen to protect.”*

Mark Iley, Investment Manager at BEF said *“Virtuoso is a strong agile and dynamic business led by a knowledgeable and experienced Principal. It was a pleasure to provide a loan facility that will enable Liz and the Virtuoso team to successfully navigate their way through the current COVID-19 pandemic.”*

The Northern Powerhouse Investment Fund project is supported financially by the European Union using funding from the European Regional Development Fund (ERDF) as part of the European Structural and Investment Funds Growth Programme 2014-2020 and the European Investment Bank.

Appendix 2: Personal Lending CDFI Case Study



It has always been clear to Sharon MacPherson, chief executive of Scotcash, a CDFI in Glasgow, that her customers are careful with money. *“They might be excluded from mainstream financial services, but they’re exceptional at managing their budgets.”* So when Covid-19 struck how did it affect customers – and what was the impact on Scotcash’s products and services?

“There was an immediate and significant drop in demand in March,” says Sharon, *“with applications reducing by around 70% and loans reducing by about half.”* The affordable credit provider, established since 2007, was receiving 4,000 applications per month this time last year; now it’s 1,000, she says. Despite the drop in demand for credit, Scotcash was agile and offered other services to support its customers’ acute financial needs.

Flexible products

As it became clear the UK needed to enter lockdown and temporarily close much of the economy to address the crisis, there was an immediate increase in requests for payment holidays.

“Before the crisis less than five percent of customers sought payment holidays,” says Sharon. *“When the crisis started, we communicated with all our customers – well before the FCA instructed credit providers to do so – and offered payment holidays. Around a third of customers are now doing so.”*

While this was clearly the right thing for this ethical lender to do, and Sharon is proud her team were proactive in offering payment holidays early, there’s naturally been an impact on Scotcash’s income, with a big drop in loan repayments. And Sharon is concerned about the future impact on customers:

“Customers generally borrow from Scotcash in early summer and the run-up to Christmas,” says Sharon. *“They’re really good at managing their money and don’t like to take on a loan unless it’s necessary. We’re worried that many people who’ve taken payment holidays now won’t have been able to pay off more than half of their existing loans if they need a loan again at the end of this year.”*

Personalised support

Sharon and her staff spent a lot of time on the telephone with customers in April and May. A grant from Foundation Scotland gave Scotcash the means to make hardship awards of £50 each to 80 households, all existing customers. *“Talking on the phone allowed us to do what we do best: help customers with their specific and overall financial circumstances,”* she says.

“We identified eligible people for the hardship grants through these conversations, their requests for payment holidays, and by our team pinpointing vulnerable households which needed support. We used flexible criteria: our only key requirement was that customers had been ‘impacted by the crisis’ so there were all sorts of different circumstances: customers who had been furloughed and lost 20% of their income; others who had been made redundant; some whose household expenses had shot up because they were shielding and could only get groceries from more expensive places than normal.

“We had conversations with every single one of these households. We looked at their specific circumstances and we’d identified what support was available in each local authority area. Most customers didn’t know what help they could get from their local council, so they really valued us finding this for them. We told them about our online benefit checker tool too. There’s a big assumption that people on low incomes know everything they are entitled to, but they really don’t.”

Lockdown meant Scotcash could not give people face-to-face advice, though. *“There are a cohort of customers who we know can’t use online services,”* says Sharon, *“so our loan officers were proactive in contacting them and helping them where necessary, building their confidence and digital skills.”*

Online Benefits Checker

Alongside the human touch, Scotcash has used social media to continue spreading the word about its online benefits checking tool, especially in May and June. This was particularly helpful for people – whether Scotcash customers or not – who’d been newly made redundant during the crisis. They could identify any tax credits and other relevant benefits.

This had an enormous impact. In February, March and April there were 52 benefit checks made with the tool, identifying over £1,400 of benefits for users. But in May and June, 136 benefit checks were made and over £26,400-worth of benefits were identified through the tool by users. This puts money they are entitled to, but often don’t access, into their pockets and households—a lifeline at a time of unprecedented pressure, saving many the need to take on debt.

Scotcash had launched this online “Money MOT” service in 2018, initially as a one-year pilot. An independent evaluation found Scotcash “a pathfinder organisation in improving digital access to the services they offer.” It added that the learning would benefit other parts of the affordable credit sector and “improve individual financial capability and ultimately contribute to reducing reliance on illegal money lenders.”

Innovative products and partnerships

A new partnership with Snoop, a free money management app, launched in July 2020. This useful money-saving tool is being offered to everyone who applies to Scotcash for a loan, whether or not they are successful. It continues Scotcash’s long track record in effective partnership working. Collaborations with Money Advice Scotland, Glasgow CAB, and numerous local authorities and housing associations have all been effective thanks to a shared purpose between Scotcash and partners to support the most vulnerable.

High customer satisfaction

Customers’ feedback about Scotcash during lockdown remains exceptional, with participants in a customer survey making comments including *“the Scotcash adviser was a joy to interact with, from start to finish she was incredibly helpful, friendly, positive and empathetic, and I cannot put into words how good the level of service offered to me was”* and *“the person I spoke with was beyond helpful, she went out her way to help me. Brilliant service.”* 93% of customers described Scotcash’s services as very high or high quality.

Local authority partners, politicians, policymakers, journalists, academics and funders frequently praise Scotcash for the difference its financial and wraparound services make to customers’ lives. Clearly this award-winning and resilient CDFI adapted fast to the demands of the unprecedented crisis of 2020. But can it weather the storm? 2018-19 had been a particularly strong year for Scotcash. It expanded across UK, increased both the number of affordable loans it made and its turnover by around 40%, and reduced its cost of delivering each loan by over a third. What now?

“We are completely committed to realising our growth ambitions across the UK,” says Sharon, *“and we’re pursuing opportunities to ‘digitise’ financial exclusion services, such as automated benefit checking, savings schemes, and promotion of budgeting apps like Snoop.”*

But Sharon would *“love to see a more strategic and joined up approach to financial inclusion across the UK. It’s fantastic to see the work of Fair4All, but the dormant account funding that’s come to Scotland isn’t going into financial inclusion – it’s gone to a youth fund. This is a UK strategic and structural issue and we should be responding in a strategic way; for me the starting point would be for all UK nations to be on the same page.*

“We’re proud of every pound we can save our customers, every pound we can help them to put into a savings account, and every way we can help make life fairer for them.”