Access to Money: The Mayor's role in promoting financial inclusion – Responsible Finance response

September 2017

About Responsible Finance

Responsible Finance is the trade body for responsible finance providers (also known as community development finance institutions (CDFIs)). Responsible finance providers provide loans and support to SMEs and consumers who find it difficult to access finance from commercial banks. Responsible Finance's mission is to support the development of a thriving and sustainable sector that provides finance for underserved communities and, as a result, contributes to increasing economic growth and prosperity of these communities. Responsible Finance has five members that lend to SMEs, charities and consumers in London that together have an outstanding loan book of over £30 million. Annually our members lend over £16 million to 4,500 individuals and hundreds of businesses and social enterprises.

About the responsible finance sector

Access to finance and financial exclusion continue to be significant barriers to growth and long-term prosperity in local economies across the UK, at the individual, household, and business levels. Despite the economic recovery and a wave of new entrants such as challenger banks and alternative lenders, there is still a large minority of businesses and people that cannot access the finance they need to achieve their goals. **Since 2011, high street banks have withdrawn £24 billion from the SME sector[1] and nearly half of all SMEs are now choosing not to borrow at all.[2] For consumers, 2 million people, or 3% of the population, do not have a bank account and a further 4 million people incur regular charges on their accounts.[3]** These indicators point to a persistently significant gap in access to appropriate finance, and the fragile nature of improvements in financial inclusion to date.

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[1] Bank of England, http://www.bankofengland.co.uk/boeapps/iadb/NewInterMed.asp

[2] BDRC SME Finance Monitor Q2 2017, http://bdrc-continental.com/products/sme-finance-monitor/

[3] University of Birmingham, *Financial Inclusion annual Monitoring Report 2015*, http://www.friendsprovidentfoundation.org/wp-content/uploads/2015/10/University-of-Birmingham-Financial-inclusion-report-2015-final.pdf

This gap has been driven by a lack of competition and transparency in the financial services sector, along with credit tightening policies, low levels of financial literacy and awareness of alternatives to bank finance. The inability to access appropriate financial services creates a drag on the economy and has led to financial instability, problem debt, and decreased productivity. This not only erodes society but also limits people and firms' participation in the economy.

The impact of the responsible finance sector in the UK

Our monitoring of the responsible finance sector indicates that in the decade from 2005-2015, responsible finance providers across the UK:

- Lent £1.6 billion to 280,000 people, businesses, and social enterprises;
- Financed 50,000 businesses and 4,100 social enterprises;
- Enabled the creation of 68,000 jobs and protected another 41,000 that were at risk. This constitutes up to 5% of the UK's total job growth each year;
- Helped 40,000 new businesses and social enterprises start up, fuelling the economy with £0.6 billion annually (2% of last year's growth in GDP);
- Helped 216,000 people save £20 million in repayments to high cost lenders, and tackled 2% of the UK's problem debt;
- For every £1 responsible finance providers lend, they generate £7 in economic value.

Evidence

- **The extent of financial exclusion in London, how it manifests itself and what are the main causes?**

Financial exclusion and low financial capability in both SMEs and individuals is persistent across the UK. Many national trends were reflected in London. Following the 2007-2008 financial crisis and depressed growth rates which continued until 2012, the landscape for access to finance for SMEs has changed dramatically.

First, the stock of bank lending to SMEs fell some 20%[4] between 2009 and 2013. In the 6 years since 2011, banks have withdrawn approximately £24 billion from the SME lending market, the most drastic decline taking place between 2011 and 2013[5]. In more recent years there are signs of credit conditions improving moderately for businesses with more loan applications being approved by banks[6].

However, when this data is unpicked, it reveals trends that indicate that access to finance remains a major barrier for some businesses. In particular, micro and small businesses report higher decline rates on new/renewed loan facilities. For micro businesses the decline rate

[4] RBS Independent Lending Review, 2013, http://www.independentlendingreview.co.uk/RBS_ILR_Full_Report.pdf
[5] Bank of England, http://www.bankofengland.co.uk/boeapps/iadb/NewInterMed.asp
[6] British Bankers Association, https://www.bba.org.uk/news/statistics/sme-statistics/; BDRC SME Finance Monitor Q2 2017, http://bdrc-continental.com/products/sme-finance-monitor/

remains notably high – 31% for those with 0 employees and 35% for those with 1-9 employees[7]. Based on reports from our members, the largest demand they see (from businesses that have been previously formally or informally declined by a bank) is micro and small businesses seeking less than £150,000 for start-up or growth finance. In 2016 responsible finance providers lent £103 million to 9,600 small businesses, creating 8,200 new businesses and creating or saving 14,900 jobs.

Evidence from our London-based members suggests that the only alternatives for small scale SMEs, that do not have adequate security, may have adverse credit history, or no track record outside of responsible finance is high cost online lenders such as iWoca, Capital On Tap, and EZbob, which can charge up to 150% for a 12 month loan. As business lending is unregulated these lenders are not transparent about pricing and as a result many small businesses are taking on unsustainable debt.

Similarly when looking at financial exclusion on the consumer side of the market national trends are mirrored in the London market. **6 million people, 10% of the population, either do not have or struggle to use their bank account.[8]** They will frequently turn to alternative forms of finance to make ends meet, such as high cost payday lenders or illegal loan sharks. Cuts to welfare, stagnant wages and economic instability over the past decade have exacerbated the precarious position of many in the UK. Increasingly, traditional lenders in this area, such as Provident, are moving to better-off, less risky groups and not catering for the non-prime personal market. In fact the Provident Finance Group has 50% fewer home credit customers than in 2013.[9] The FCA reports that its interventions into the high cost short term credit markets withdrew credit from 800,000 individuals.[10] In contrast, the responsible finance industry is committed to supporting this segment of the market, often providing wraparound services to promote financial wellbeing and literacy, and encourage saving. In 2016 responsible finance providers helped their customers deposit £3 million in savings accounts, and supported almost 37,000 individuals with £20 million in loans.

These UK-wide trends reflect market conditions in London as well, and this is evidenced by increasing demand year over year for responsible finance. It is difficult to pinpoint levels of unmet demand in London as there is not sufficient data available on lending. Currently banks disclose their lending by post code sector, on a voluntary basis,[11] however as this geographic measurement covers entire boroughs of London, the data cannot be used to detect pockets of exclusion. Responsible Finance has done analysis in previous years to map bank lending data with lending by responsible finance providers, and the indices of multiple deprivation. This exercise has demonstrated that responsible finance providers tend to lend into communities that face higher levels of deprivation and receive less bank funding. Below are three examples of 2015 maps in London showing bank personal lending, responsible finance provider (CDFI) personal lending, and indices of multiple deprivation in boroughs of East London. These maps indicate that banks have lower levels of lending in areas of higher deprivation in Tower Hamlets, Hackney, Haringey, and Waltham Forest, while responsible finance providers actually concentrate in these areas.

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[7] BDRC SME Finance Monitor, Q2 2017, http://bdrc-continental.com/wp-content/uploads/2017/09/BDRC_SME_Finance_Monitor_Q2_2017.pdf

[8] University of Birmingham, *Financial Inclusion annual Monitoring Report 2015*, http://www.friendsprovidentfoundation.org/wp-content/uploads/2015/10/University-of-Birmingham-Financial-inclusion-report-2015-final.pdf

[9] Carnegie UK presentation

[10] FCA, https://www.fca.org.uk/news/press-releases/fca-launches-call-input-high-cost-credit-and-overdraft

[11] UK Finance, https://www.ukfinance.org.uk/statistics/postcode-lending/

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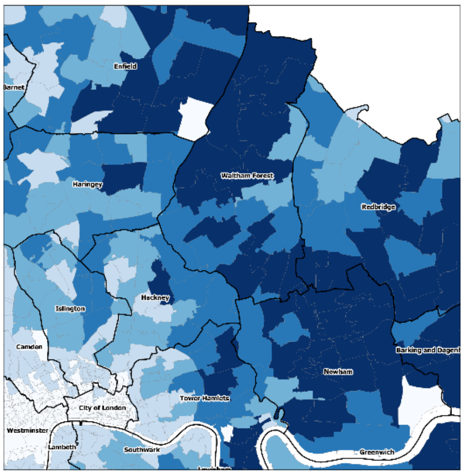
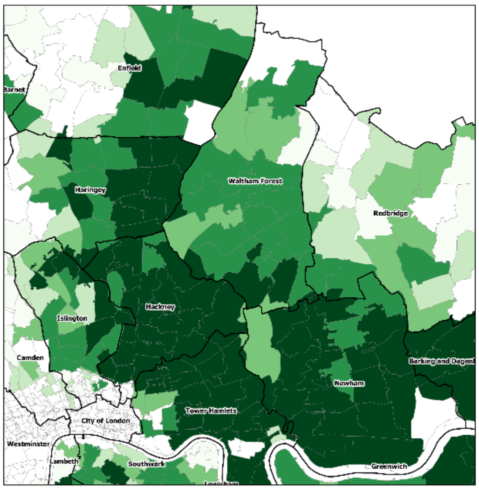
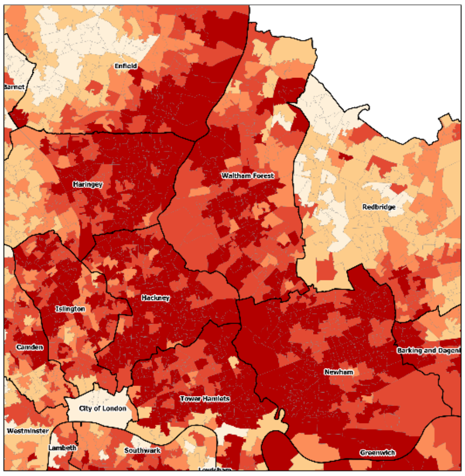


Total value of bank lending Q1-4 2014
- £0 - £1.954m
- £1.954m - £13.149m
- £13.149m - £18.131m
- £18.131m - £23.388m
- £23.388m - £49.627m



Total value of CDFI lending
- £0
- £0 - £0.8k
- £0.8k - £1.7k
- £1.7k - £3.4k
- £3.4k - £7.7k
- £7.7k - £45.8k



Indices of Multiple Deprivation 2010 (Percentiles)
- 0 - 20% (most deprived)
- 20 - 40%
- 40 - 60%
- 60 - 80%
- 80 - 100% (least deprived)

National trends are exacerbated in London, where the cost of living exceeds other places in the country, and where wages have also continued to stagnate. This and the rise of income precarity through zero hours contract jobs leads to stress on income and reliance on credit to get by. Given the economic outlook, these trends are likely to continue. As the FCA looks to intervene in other credit sectors, such as home credit and rent to buy, consumers will have fewer options for credit when facing both anticipated and unexpected costs.

- **The kinds of support currently available to those financially excluded?**

Support for financially excluded SMEs and individuals includes access to alternative credit such as responsible finance providers and credit unions. There are also national networks for debt and money advice such as StepChange and Citizens Advice. There may also be local initiatives within the borough or community. For example responsible finance provider Fair Finance is part of a Thamesmead Advice Partnership, which provides advice and financial capability support to Thamesmead residents. These types of partnerships deliver value as they are tailored to local conditions and use proven routes to market.

For SMEs the advice and support landscape is more fragmented since the dissolution of Business Link and the consolidation of the enterprise agency network. Online referral platforms have been established as part of the Government's effort to increase access to finance, however these designated platforms are new and have yet to demonstrate an impact on the SME finance market. Many small businesses prefer a face to face interaction, and the platforms have not tackled the issue of advice or constructive declines.

For both the SME and consumer markets, the support network is not joined up, and for those excluded it can be challenging to navigate and understand alternatives. Responsible finance providers often engage in partnerships with other advice and lending organisations to join the dots within the ecosystem so those excluded from mainstream finance are not left behind.

- **What impact will the closure of high street bank branches have on lending to smaller SMEs?**

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Bank branch closures have affected businesses and consumers across the UK. The impact of branch closures has been particularly pronounced in rural parts of the country businesses operate on a cash basis, and without a branch it is difficult to make deposits.[12] Many small and micro businesses in London still operate with cash, so making large deposits is an issue. Although many banking functions can now be completed digitally, businesses seek face to face interactions when making high-impact decisions, such as taking out a loan. The closure of bank branches and comprehensive advice makes it difficult for small businesses to understand options around financing different projects. Lack of access to branch services such as deposits and informal business advice have an impact beyond financial, on the business' confidence and ambition to expand and innovate.

- **What scope is there for the establishment of community banks to support lending to SMEs unable to access mainstream financial services?**

Community or regional banks are often cited as a potential solution to financial exclusion, given their prominence in other countries such as Germany. Although community banks seem like an attractive option, there is no evidence that they would effectively tackle the scale of financial exclusion in the UK. Setting up a new bank requires significant upfront investment particularly around the compliance and IT functions. Ongoing compliance with banking prudential regulations and capital requirements means that these banks will automatically not be able to serve some of the most vulnerable or excluded populations, because those segments are loss-making. ***This has been demonstrated by the number of challenger banks that were started after the 2008 financial crisis which now serve the same lower risk segments of the SME market as the mainstream banks.***

Although the drivers of a local banking model are well placed, in reality it has not proven the solution to the UK's financial capability needs. As an alternative, there are local finance organisations currently operating in every locality, including London that together emulate the local banking model. If responsible finance providers, credit unions, and advice agencies worked together in a more joined up way they could achieve scale to fill the gap in the market. Responsible Finance published research in 2017 analysing partnership models and their potential for scale.[13] In London this means providers such as Fair Finance collaborating on the delivery of products and services.

- **What has worked well and what areas could be improved?**

There are examples of initiatives achieving impact on a local level, but that lack the capital to scale up to cover a wider region. For example the advice collaborative that Fair Finance is part of operates in Thamesmead is an effective way of reaching migrant and vulnerable individuals and families with tailored advice, but this level of support is not available across the city. This is due to lack of investment to expand existing infrastructure (branch offices, qualified staff, marketing initiatives). The organisations that deliver this advice collaborative are not for profits, which often do not generate enough surplus to reinvest into innovation and systems.

We know that working in partnership can deliver the scale results to tackle financial exclusion and low financial capability at a city, or even country level. But it requires resources – both investment and people to effectively plan the intervention.

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[12] FSB, *Locked Out: the impact of bank branch closures on small business*, http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-bank-branch-closures-(final).pdf?sfvrsn=0

[13] Responsible Finance, *Tackling Financial Exclusion through Local Finance Partnerships*, http://responsiblefinance.org.uk/download/tackling-financial-exclusion-through-local-finance-partnerships/

On the SME lending side, national programmes such as the Regional Growth Fund (more detail below) delivered through responsible finance providers are effective at improving credit conditions for underserved SMEs. The government has since launched regional funds such as the Northern Powerhouse Investment Fund and the Midlands Engine Investment Fund. These funds are delivered by local intermediaries, such as responsible finance providers that have an existing route to market. These targeted funds delivered through intermediaries have demonstrated success at improving economic opportunity for SMEs; however these funds are not consistent across the country, and there is not a London-specific fund. Using RGF or the regional funds as a blueprint to develop a dedicated London fund could increase access to finance for underserved SMEs.

- **How successful have government and financial initiatives been to make funds available to SMEs and to encourage banks to lend?**

Following the 2008 financial crisis the UK Government took a number of steps to improve access to credit for SMEs. These include:

- **Regional Growth Fund**: The Regional Growth Fund (RGF), launched in 2010, has invested £2.7 billion in SMEs across England through six rounds[14]. In particular the Responsible Finance RGF 1 programme was a £30 million fund from BIS and leveraged in £30 million in private investment from banks (Unity Trust Bank and the Co-operative Bank).

  This £60 million fund, distributed through responsible finance providers, was targeted at the micro and small segment of the market that struggles the most to access finance, and for which this finance has a disproportionate impact, not to mention the benefit to the local economy. Repaid grant funds are re-matched by bank loans and 'recycled' into new beneficiary loans.

  To date, Responsible Finance's RGF programme has surpassed its own targets, and outperformed other RGF schemes on a number of KPIs. As of June 2017, £62.7 million had been disbursed to over 2,000 microbusinesses and SMEs. This has created and saved 8,514 jobs. The resulting cost per job to the government is £3,685, which is 7% of the total cost per job across the entire RGF programme[15].

  100% of the nearly 2,000 businesses supported had been previously declined by a bank, and a large proportion have been high growth, as evidenced by the number of new jobs created. However, no new rounds of RGF have been announced.

  As evidenced by the KPIs, this was an effective intervention by the government that was also good value for money, while also improving the landscape for access to finance for those businesses that experience the greatest difficulties.

- **Start Up Loans Programme**: Another intervention the government has made in the micro/start up segment of the market is the Start Up Loans Programme.

[14] Regional Growth Fund, https://www.gov.uk/guidance/understanding-the-regional-growth-fund
[15] House of Commons Library Regional Growth Fund, 2015, http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN05874#fullreport

The recent British Business Bank market report highlighted that demand for finance from start ups has risen in recent years (12% in 2013, 25% in 2014)[16]. The Start Up Loans programme, delivered partially through responsible finance providers, has proven an effective mechanism of reaching start ups in underserved markets with the twin approach of business advice and finance. However, some challenges this programme has faced and should continue to consider during its evolution are:

- Credit policies and if these policies are aligned with the market it is trying to support;
- Offering a 6% product too broadly could possibly distort the market and businesses' expectations for future borrowing;
- How the Start Up Loans programme can closely integrate with local economic growth, business, and entrepreneurship strategies.

It was also noted in the British Business Bank report that start ups are more likely than existing businesses to be able to secure funding. This highlights the barrier described previously of micro and small businesses, aged 2-5 years, in obtaining finance, which the Start Up Loans programme currently does not address.

- **Enterprise Finance Guarantee Scheme:** This scheme has stimulated over £2 billion of lending[17] into small and micro businesses that would otherwise likely find it difficult to access finance due to lack of security. The scheme is a useful tool for the responsible finance sector to extend reach into underserved SME markets.

- **Funding for Lending Scheme**: This scheme was launched in 2012 to incentivise banks to lend to SMEs. In recent months there have been signs of improving credit conditions for SMEs; but there is no evidence of what segment of the market they are lending to[18].

- **What role should Government, the charitable sector and business play in promoting financial inclusion?**

Thinking practically with current players in the market there is potential to create a collaborative and effective ecosystem. Creating this ecosystem relies on the incentives for partnership and participation.

Government underpins this partnership. The role of government is to provide the tools to enable the business and social sectors to capitalise on their core strengths. This includes providing catalytic grant funds (used to leverage in commercial funds), policy tools such as guarantee schemes, seed capital for innovation and partnership projects.

The charitable and social sector, including responsible finance providers, credit unions, and advice agencies are the delivery mechanism for reaching those businesses and individuals excluded by mainstream finance. With the tools provided by government, these organisations can scale their operations to serve a larger market. These local finance organisations already have a route to market, market understanding, and customer trust, all of which cannot be underestimated when working with hard to reach markets.

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[16] British Business Bank, Small Business Finance Markets, 2015, http://british-business-bank.co.uk/wp-content/uploads/2016/02/British-Business-Bank-Small-Business-Finance-Markets-Report-2015-16.pdf

[17] Understanding the Enterprise Finance Guarantee Scheme, https://www.gov.uk/guidance/understanding-the-enterprise-finance-guarantee

[18] FT, Bank of England's Funding for Lending Scheme Extended, 2015, http://www.ft.com/cms/s/0/a8b1d864-976c-11e5-95c7-d47aa298f769.html#axzz3zZgzRDZi

Finally the business community can provide capital (for lending) and brand awareness through referrals or promotion. The business community can also support the social sector through capacity building such as knowledge sharing and pro bono support.

The incentive for the private sector to get involved is the policy support. For example catalytic grant funds or guarantees leverage in commercial investment, since the policy support de-risks the proposition. The business community often supports the social sector through CSR which is welcomed, but to tackle the scale of exclusion in the UK and in London larger scale engagement is needed from the private sector. This is where policy tools such as tax reliefs, business rate reliefs, and even legislation or regulation will incentivise more robust engagement.