2nd June 2020

About Responsible Finance

Responsible Finance is the trade body for responsible finance providers (also known as community development finance institutions (CDFIs)). Responsible finance providers offer loans and support to viable micro, small and medium sized enterprises (SMEs) in deprived and underserved communities across the whole of the UK which are unable to access bank loans or other sources of finance. They are a critical source of support that helps businesses contribute to employment and job creation. Without CDFIs, these businesses would be unable to access finance and would likely fail or be unable to grow and create jobs.

CDFIs have over twenty years of experience and success investing in communities not served by other lenders, including delivering good value for money on Government programmes such as the Regional Growth Fund. They are key strategic partners for the British Business Bank, delivering both the essential Start Up Loan scheme, as well as 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.

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

About our submission

Seventeen CDFIs are accredited to deliver the Government's Coronavirus Business Interruption Loan Scheme (CBILS), therefore our submission will focus on the CBILS and the role that CDFIs can play in the UK's economic recovery. We have developed a policy proposal that would allow the Government, through Community Development Finance Institutions, to alleviate the economic challenges facing small businesses and communities. This will put the UK securely on a path to recovery whilst at the same time "levelling up" the communities and regions of the UK:

- **£100 million CDFI fund to allow CDFIs to continue to step-up their lending to support small businesses on the route to recovery.**
  The capital for the fund would be provided at 0.1%. It could be created by enabling non-bank lenders to access the **Bank of England's Term Funding Scheme or the joint HM Treasury and Bank of England Covid Corporate Financing Facility**, *or a £100 million Government grant.*

  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.

- **Enable businesses with a Bounce Back Loan (BBL) to top-up with a Coronavirus Business Interruption Loan (CBIL) when they need more capital**
  The BBL scheme offers a maximum loan of £50,000. We propose that SMEs that have received a BBL of £50,000, but find themselves needing more, are able to access a top-up CBILS loan rather than having to convert all of their working capital requirements into a CBILS loan. This would provide flexibility to businesses whose capital needs may change over the coming months, and enable CDFIs' capital to have a greater impact. The top-up CBILS loan should be permitted to be an amount under £50,000 if required by the business.

Responsible Finance

Consultation response

Support to businesses and Financial services

- **How effective is the Coronavirus Corporate Finance Facility, Coronavirus Business Interruption Loan Scheme, and the Coronavirus Larger Business Interruption Loan Scheme? In particular, are these measures succeeding in preventing viable businesses from potentially going under during the Coronavirus lockdown?**

  Seventeen CDFIs are accredited to deliver the CBILS. As a demonstration of the sector's ability to step-up during the crisis, CDFIs increased lending by over 250% compared to the same period in 2019. So far they have lent over £18.5 million to micro, small and medium sized enterprises across the UK, and protected over 2,000 jobs.

  We believe the CBIL scheme is succeeding in preventing viable business closures, however there remain a number of gaps which we have outlined in the questions below. There is also a persistent issue with the messaging around the scheme. Given its name as a loan scheme, it has been difficult to communicate to small businesses that it is a Government-backed guarantee, rather than direct Government money. As such, CDFIs and other non-bank lenders are not able to lend at their full potential due to access to capital.

- **How effective has the Government support been so far in terms of coverage and speed?**

  We applaud the bold steps taken by the Government to meet the needs of SMEs and microbusinesses at the scale required to prevent businesses failing due to a lack of cash in the short-term, and their speed in setting up the schemes. We believe it has been effective in part, however large gaps in provision exist and must be filled as the UK moves into the recovery to prevent business closures and job losses.

  Outside of the Coronavirus Corporate Finance Facility, Coronavirus Business Interruption Loan Scheme, and the Coronavirus Larger Business Interruption Loan Scheme, many microbusinesses are falling through the cracks for Government's other support measures across the UK. Some of the reasons for this are outlined below:

  - Business rates relief: many microbusinesses, particularly in more disadvantaged communities, do not pay business rates. Therefore they cannot benefit from this support.
  - Business grants: as these are linked to a businesses' rateable value many cannot access these. In addition, businesses need at least one employee who isn't the business owner – ruling out all sole traders and partnerships.
  - Support for the self-employed: this is based on net earnings. Most self-employed people report very low or no net earnings for their first few trading years. This leaves Universal Credit as the only option, but this is not sufficient to cover business costs.

- **What gaps are there for businesses within the schemes?**

  We have identified the following gaps in support for SMEs with the Bounce Back Loan scheme and the Coronavirus Business Interruption Loan Scheme:

Bounce Back Loan Scheme (loans of less than £50,000)

- Businesses which need more personalised support and mentoring alongside funding.
- Businesses which don't bank with any of the currently accredited lenders, or do their business banking using personal accounts.

Coronavirus Business Interruption Loan Scheme (loans of £50,000 - £5,000,000)

- Businesses which need more than £50,000 but are unable to access the scheme through other lenders. CDFIs are being approached by businesses which are looking for up to £500,000, yet due to their own funding restrictions they are unable to help all the viable businesses which approach them.
- Businesses which have borrowed up to £50,000 from the BBL scheme who need follow-on finance. Businesses are not currently allowed to top-up a BBL with additional finance using the CBILS. As we move into the recovery period, businesses' capital needs may change therefore they should be able to take out a CBILS loan on top of a BBL. In this case, banks will often be unwilling to top-up the loan where CDFIs may be able to. A CBILS top-up to a BBL should be permitted at an amount less than £50,000.

CDFIs are able to fill these gaps, **however, the sector requires sufficient capitalisation to do so.**

CDFIs lend to viable businesses which banks and other lenders have declined, and channel their capital into the most deprived communities in the UK; in 2019 93% of viable businesses lent to by CDFIs were previously turned down by a bank, and 59% of CDFI business loans were made in the UK's 35% most disadvantaged areas. They are able to lend to these businesses because of their flexible, person-centred approach, and more in-depth rational processes for assessing business loan applications. They can unravel a business's situation to arrive at a 'yes' where a bank's automated credit systems have said no. This is only possible because of their highly skilled and committed staff, which mitigates the risk of lending to these businesses but is a higher cost to serve model. 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 organisations, 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.

Other Government intervention

- **Should the Government intervene more actively in terms of state aid, bail-outs and its industrial strategy?**

When delivering state-aid, the Government must be mindful not to distort the SME finance market by offering an unfair advantage to banks. The SME finance market in the UK is a comprehensive ecosystem of lenders, each with their own place in the market. CDFIs exist to serve the SMEs which would otherwise fall through the cracks with other lenders, including banks, therefore they play a critical role in their short-term survival and longer-term prosperity. There are very few lenders outside of the CDFI space which would consider supporting the borrower profile that CDFIs serve, and those that do charge prohibitive rates of interest, so if a CDFI doesn't step in then the business will likely fail.

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. This unlevel playing field risks damaging the long-term sustainability of the non-bank sector, and creating a less diverse financial services sector. Once state-aided interventions end and banks retreat from part of the SME market CDFIs will be needed more than ever, so it is important that the non-bank sector is given the opportunity to remain vibrant.

CDFIs along with other non-bank lenders, should have parity with the banks on raising finance. **This includes access to a £100 million fund for the sector at 0.1% through the Bank of England's Term Funding Scheme or the joint HM Treasury and Bank of England Covid Corporate Financing Facility, or a £100 million Government grant fund.**

Economy, public finances and monetary policy

- **What will be the economic impacts of the coronavirus outbreak and the social distancing measures in terms of sectors and regions and how temporary/permanent will they be?**

Data has revealed that the rate of deaths involving Covid-19 is approximately twice as high in the most deprived areas of England and Wales compared to the least deprived. It is therefore imperative that we strive for an inclusive recovery which levels up the disadvantaged regions of the UK, so communities emerge from the crisis strengthened and resilient. 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.

Because of their focus on building regional economies, CDFIs particularly target businesses located in higher areas of deprivation, and those which will make significant employment impact. The sector has a strong presence across the regions, including in the Northwest, Yorkshire and the Humber and West Midlands. The UK's strategy to level up is particularly relevant to the recovery, which could see uneven progress if investment is mainly targeted at London-based businesses. CDFIs are well positioned to channel investment into traditionally overlooked businesses, helping them to rebuild and add new employment in the months to come.

Business investment is also a key driver of productivity, and the decline of investment as proportion of domestic output in the past three decades has had an impact on the UK's low productivity[1]. 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.

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.

[1] Civitas (2018) Closing the Finance Gap.

The latest British Business Bank Small Business Finance Markets report finds there has been significant growth in the volume of finance outside of traditional bank lending products[2]. But the influx of alternative online lenders has not proved to boost productivity. Evidence shows that peer-to-peer lenders lend to low-risk bankable businesses, not filling the finance gap for the businesses that cannot or are discouraged from seeking bank finance. CDFIs are the only lenders which are actively targeting the gap in access to finance with fair and affordable products. They also provide advice, support and confidence building which enables businesses to make decisions that increase their productivity.

Government investment in disadvantaged areas through capitalising the CDFI sector will help businesses to rebuild, boost productivity and create new employment in the months to come, providing a route to recovery.

- **What will be the impact on inequalities within society and how should the Government address inequalities that may have been exacerbated by the crisis?**

  SMEs and microbusinesses are instrumental to the UK's recovery from the Covid-19 crisis, therefore they need fit for-purpose and accessible financial services shaped by positive Government policies which value CDFIs. Enabling CDFIs to access to low-cost capital will bolster the sector's growth and enable the UK to recover from the crisis in an inclusive way; by lending to disadvantaged and underserved entrepreneurs which otherwise wouldn't be able to access finance. In 2019, 42% of loans were made to women-led businesses and 15% went to Black, Asian and Minority Ethnic-led businesses. By giving the CDFI sector the tools to operate at greater scale, the government can ensure that inequalities that have been exacerbated by the Covid-19 crisis are temporary, and that those businesses and entrepreneurs that are typically overlooked have access to the finance that they need to grow. CDFI lending always has a social and economic impact; each loan the sector makes will protect and create new, good jobs during the economic recovery. Focusing on a balanced and inclusive recovery will ensure the recovery is as close to "V-shaped" as possible.

  A strengthened CDFI sector would support wealth building, community revitalisation, and economic growth in disadvantaged areas, whilst helping to create a more coordinated, strong and diverse SME finance market. This approach will help to address the inequalities which have been exacerbated by the crisis.

- **What will be the impact on the public finances?**

  - What are the potential future implications for tax and spending? n/a

  - **What are the implications for the Government's "levelling up" agenda announced in the Budget/infrastructure strategy?**

    It is imperative for the UK's recovery that the Government continues its "levelling up" agenda. A strengthened CDFI sector will play a key role in levelling up deprived communities across the UK by helping to protect and grow businesses and creating good quality employment opportunities.

[2] British Business Bank (2020) Small Business Finance Markets 2019/20.

- **What are the differences and similarities between this shock and the Great Financial Recession of 2008 and also the economic demand management and demand suppression policies pursued during the Second World War? What lessons can be learnt from these past shocks and the recoveries that ensued?**

  After the 2008 financial crisis, banks retracted from lending to the SME market. From a peak of £657 billion gross lending to the non-financial private sector in December 2008, lending had shrunk by £151 billion to £506 billion by December 2011[3]. Without incentives such as the BBL and CBILS, banks and other lenders will again retreat from the smaller scale small business market. In order to fill this gap, investment is needed now in the CDFI sector.

  The Regional Growth Fund (RGF) was created by the Government after the 2008 financial crisis to support programmes which create economic growth and lasting private sector employment. The Responsible Finance (Economic Growth) Co-Investment Wholesale Fund is an example of a good value for money and high impact partnership with the CDFI sector to support the growth of underserved markets, small and medium sized enterprises (SMEs) and social enterprises, which were unable to access mainstream finance. The programme was designed to cover all the English regions but to focus on those disadvantaged areas most dependent on public sector employment.

  £30 million was allocated to the CDFI sector, which was matched by the partner banks in each lending round to a total of £45 million to date. The Government money is critical to continuing to leverage this private sector capital, to build the capability of CDFIs and enable them to keep lending in their communities. By 31st December 2019, repaid capital from the original fund had been recycled into new loans, bringing total lending to almost £90 million. This has so far supported 11,770 jobs, exceeding the original target set by the Department for Business, Energy and Industrial Strategy of 8,746 jobs.

  CDFIs have supported businesses and social enterprises across a range of industries through the RGF programme, including manufacturing, clean energy, engineering, software and retail, all of which would otherwise not have been able to access the finance they needed to succeed. **The good-value programme could provide a blueprint for future funding models but it is vital that any new schemes must include the devolved nations of the UK.**

- **What are the lessons that society can learn for the future e.g. reducing carbon emissions, increased home working, business resilience?**

  Protecting and enhancing the resilience of the UK's businesses is an essential lesson for the future, and access to appropriate and affordable finance is a key factor in SME resilience. The Government should act now to strengthen the CDFI sector so it can support more viable businesses to build their resilience for the future.

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

In addition, CDFIs are well placed to support the Government in reducing carbon emissions, which is a key element of transitioning to a just and fair UK, particularly in light of the Coronavirus pandemic. 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. A recent example of this was Pure Haus, a Leeds-based ecological housebuilder which needed a funding lifeline to continue building one of the few UK developments in which all the homes will meet the strict 'Passivhaus' standard. When a larger funding facility, vital to the work, was delayed because of the Cornavirus crisis the entire Pure Meadows project was put at risk. CDFI Business Enterprise Fund was able to step-in to provide the company with a £50,000 Coronavirus Business Interruption loan.

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.

This submission was made in consultation with our business lending members. Our members would be happy to give any further evidence or input that the committee requires. Members which are accredited for the Coronavirus Business Interruption Loan Scheme are:

ART Business Loans

AskIf Inclusive Finance

BCRS Business Loans

Business Enterprise Fund

Coventry Warwickshire Reinvestment Trust

DSL Business Finance

Enterprise Answers

Finance for Enterprise

First Enterprise

GC Business Finance

Let's Do Business Finance

MSIF

Newable

Robert Owen Community Banking

SWIG Finance

UCIT