Responsible Finance

4th August 2020

BEIS Economic Recovery: Responsible Finance Submission

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 provider[1].

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 microbusinesses and SMEs in more deprived areas of the UK that are not served by other lenders, to help them to protect and create jobs, boost productivity, foster inclusive growth and facilitate enterprise creation.

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. CDFIs are able to lend to these businesses because they are driven by their mission to create local social, economic and environmental benefit. They take a flexible, person-centred approach, and have more in-depth processes for assessing business loan applications than other lenders.

CDFIs are key strategic partners for the government and the British Business Bank. They deliver 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.

[1] Responsible Finance, The Industry in 2019.

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.

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.

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

Our recommendation

We have developed a policy proposal that would allow the Government, through Community Development Finance Institutions, to: protect and create jobs in communities and businesses which have fallen through the cracks; boost productivity; foster inclusive growth and inspire and facilitate enterprise creation. 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.

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. By unlocking £100 million in funding for the CDFI sector, the Government could protect 13,000 UK jobs[2] during the critical recovery period. Because the businesses CDFIs lend to are located in the more deprived areas of the country, these jobs retained have a multiplier effect on sustaining the local economy.

[2] Figure based on job outcomes from previous CDFI funding programmes.

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 government is the most effective way of compelling the banks to invest in CDFIs. After the 2008 financial crisis, banks retreated from lending to the SME market; reducing lending by £151 billion between 2008 and 2011[3]. Prior to the COVID-19 pandemic, given both latent and nascent demand for finance from SMEs, several studies have put the scale of the gap in access to finance as over £1 billion. Without incentives such as CBILS and the Bounce Back Loan scheme banks will again retreat from the small business market. CDFIs must be sufficiently capitalised to step-in and meet this unmet demand.

In addition, **the UK's pipeline of investible businesses could be strengthened by making bank-referral platforms fit for purpose. At the moment, bank referral platforms generally refer customers to inappropriate and very high cost lending solutions as these pay the platforms the most commission.**

Green recovery

How to capture economic growth opportunities from the shift to net zero carbon emissions.

The Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science recently released a policy brief emphasising the pivotal role of SMEs in delivering a just transition to net-zero greenhouse emissions. This is because of their role in generating employment, economic prosperity, innovation and social cohesion, particularly in 'left behind' regions. The brief highlights the importance of finance to support SMEs in the transition to net-zero emissions, and emphasises the role of CDFIs in financing the SMEs and social enterprises that are not served by other lenders:

'Community and responsible finance institutions are also significant due to their local knowledge, social outcomes focus, flexible approaches and experience of blended finance opportunities. This means they reach SMEs and social enterprises that commercial finance may not. This includes loans to businesses focused on sustainable, people-centred outcomes and business models. These institutions may also be more attuned to the needs of minority and ethnic groups and have a history of support for diversity.'[4]

CDFIs are well placed to support SMEs and social enterprises to contribute to the transition to net-zero carbon emissions. The transition to a net-zero economy risks leaving more places behind as investment is targeted at innovative businesses in city centres; through their reach into the regions, the CDFI sector can ensure that businesses in towns and communities across the UK get the finance they need to invest in becoming low carbon. There are hundreds of community projects, sustainable businesses and social enterprises across the UK making a positive environmental impact which would not exist without CDFIs. 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.

[3] Henry, N. & Craig, P. (2013) Mind the Finance Gap: Evidencing Demand for Community Finance
[4] Tickell S., Robins N. (2020) Policy Brief: Financing small and medium enterprises to support a just transition to net-zero emissions in the UK.

Increasing opportunity

How to level up economic performance across the UK, including through skills and apprenticeships.

CDFIs are currently the only entities solely focused on investing into disadvantaged communities through loans to SMEs and social enterprises unable to access finance from mainstream sources. They target their lending to businesses located in higher areas of deprivation or in underserved communities, and those which will make a significant employment impact. In 2019:

- 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.

By financing businesses in the more deprived communities of the UK, CDFIs help to revitalise and bring employment to these communities. This provides opportunities to people within those communities, helps to build local economies, and creates wealth and prosperity.

CDFIs' commitment to tackling the climate emergency and reducing the UK's carbon footprint through investing into innovative and sustainable businesses also helps to revitalise and grow left-behind places.

Backing new businesses

To make the UK the best place in the world to start and scale a business.

Start ups are crucial to the UK economy. They stimulate competition, spur innovation and create new jobs. CDFIs deliver the Government's Start-Up Loan scheme and they have seen a significant uplift in demand in recent weeks as people begin to think about their aspirations after lockdown. Some people facing redundancy are also looking into starting a business. CDFIs provide support alongside finance, helping the unemployed transition into meaningful employment. These businesses will also need follow on funding in 12-18 months, and will likely still be too small and high risk for banks; with appropriate capital the CDFI sector can continue funding those businesses and help them become bankable in the long-term.

A viable business idea may fail because the entrepreneur has a lack of business experience and does not have the right advice and support in place to compensate for this. This means that businesses often do not have the resilience to survive the first two critical years. In addition, a perception that loan funding support is hard to obtain, poor signposting to sources of support, and a perception that an entrepreneur could 'lose everything' if a venture fails also act as barriers to starting and growing a business in the UK. In order to offset this, in additional to appropriate finance, entrepreneurs must have access to support, advice and business coaching.

In the UK poverty can also stifle innovation and entrepreneurship amongst those who are on benefits or left behind by the economy. The benefits system does not enable people to try out business ideas and withdraw if they do not work and try again. It prevents people saving up to start a business, so that those who do manage to start have no back up funds to cope with set-backs. It perpetuates precarious lifestyles which make it extremely hard for people at the bottom of the pile to start up and succeed, and means most funders except CDFIs will not lend to them.

The Government must put more value on microbusinesses, and in particular sole traders. These entrepreneurs create bottom-up economic development which is needed now more than ever. Flexible, local, small businesses which are rooted in their communities, use local suppliers and products, and retain profits for local benefit, are crucial to the UK's economic recovery. They revitalise deprived areas and level up disadvantaged communities.

Enabling CDFIs to access low-cost capital will bolster the sector's growth and enable it to back more start up and scaling businesses.

The future of industry

How to accelerate business innovation and leverage private sector investment in research and development.

Business investment in innovation 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 productivity[5].

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. Productivity enhancing improvements include digitisation, commercial excellence, talent management, planning for the future, leadership and operational efficiency[6]. These improvements require investment in people, business development and organisational capacity.

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.

It is estimated that around one in ten SMEs (9.3%) across the UK can be classified as a 'discouraged' borrower, which amounts to half a million SMEs[7]. The British Business Bank also reported that the share of SMEs willing to use finance to grow and develop fell sharply from 45% to less than 30% in 2019[8]. To help offset this discouragement, in addition to being sufficiently resourced, we believe Growth Hubs should have grants available to be delivered alongside a panel of businesses advisers, mentors and coaching support. These mentors should be former business owners and entrepreneurs.

It is crucial that local business networks and ecosystems work in synergy with one another towards a common goal, with a combined plan for their area focusing on each of their strengths. The ecosystem is currently a little siloed therefore work to address this will strengthen ecosystems and equip areas better to deliver growth locally. As standard, CDFIs provide business mentoring and support to their investees.

[5] Civitas (2018) Closing the Finance Gap.
[6] McKinsey & Co (2016) Productivity: The route to Brexit success
[7] Brown R., Linares-Zegarra J., Wilson J. (2018) An empirical examination of discouraged borrowers in the UK. Enterprise Research Centre.
[8] British Business Bank (2020) Small Business Finance Markets.

This must also apply to Scotland, Wales and Northern Ireland. There must be parity of support in the devolved nations.

The UK open for business

How to win and retain more high value investment for the UK.

n/a

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

Scotcash
approachable finance

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."