SMALL CHANGE RESEARCH PARTNERSHIP

FINANCIAL INCLUSION SERVICES RESEARCH

SUPPLY SIDE

5 THE QUAY, KILLYLEAGH, BT30 9GB, NORTHERN IRELAND
TEL 028 44822198
EMAIL: SMALLCHANGE@HOTMAIL.CO.UK

TABLE OF CONTENTS

1.	INTRODUCTION	3
2.	TERMS OF REFERENCE AND METHODOLOGY	4
3.	POLICY AND FUNDING CONTEXT	6
4.	AVAILABILITY OF FINANCIAL SERVICES IN SOUTH EAST	15
5.	GAP ANALYSIS	31
6.	SUSTAINABILITY OF EXISTING PROVIDERS	33
7.	SUMMARY AND CONCLUSIONS	48

1. INTRODUCTION

The remit of this study is to provide SEEDA with an in-depth assessment of the nature and extent of Community Development Finance including Credit Unions in the region and to make a realistic assessment of whether and to what extent the sector can deliver sustainable services to financially excluded people.

SEEDA, in its draft Regional Economic Study, recognises that the South-East's strong economic performance has not eliminated poverty and disadvantage. There are disadvantaged geographic communities in the South-East, as well as disadvantaged groups. SEEDA's Sustainable Prosperity Objective includes key actions in relation to the stimulation of enterprise, support for locally-focused community-based business, recognition of the importance of micro-businesses and home-based businesses, the contribution of the voluntary sector and the potential for social enterprise.

CDFI's and Credit Unions can be seen as part of a growing social enterprise sector, operating with a business model that seeks to balance income-generation with a social mission to tackle financial exclusion.

The combined Community Development Finance (CDF) and Credit Union sector provides access to financial services for those who are not included in mainstream financial services. Those who suffer from financial exclusion see, for example, not having a bank account as a key barrier to getting a job. Microfinance can provide a hand-up for those with the entrepreneurial spark to start their own businesses. Social finance can provide the "fuel" to allow social enterprises to fulfil their potential.

However, in order to fulfil their potential, the CDF and Credit Union sector in the South-East needs to step up to meet the challenge of financial scale. This report reviews the scale and scope of that challenge and recommends a development path for the sector. It is hoped that it also demonstrates how SEEDA can use its leadership role in economic development in the South East to facilitate the delivery of efficient and effective financial inclusion services, to increase the economic viability of employment, to tackle the culture of worklessness and to mitigate the economic costs of financial exclusion.

2. TERMS OF REFERENCE AND METHODOLOGY

The Small Change Research Partnership was commissioned by SEEDA to produce an in-depth assessment of the nature, extent and sustainability of Community Development Finance (including Credit Unions) in the South-East of England and to make a realistic evaluation of whether, and to what extent, Community Development Finance Institutions (CDFI's) and Credit Unions can deliver services to financially excluded individuals and communities on a sustainable basis. The team for the supply side study was led by Niamh Goggin of Small Change Research Partnership, and also included Paul Thain of Experian, Claire Caffrey of the CDFA and Peter Ramsden of Freiss Ltd.

The Terms of Reference of the study were to focus on:

- The availability of financial services in the region;
- Assessment of gaps in provision; and
- Sustainability of CDFI's.

The study was carried out using three main elements:

- Compilation of primary and secondary sources;
- Focus Groups;
- Analysis.

Extensive secondary data research was conducted at the start of the study to establish the nature and scope of alternative financial inclusion providers in the South East. The study terms of reference had specifically excluded the alternative lending market such as home credit and doorstep lenders, pawnbrokers, sale and buyback shops and mail order catalogues for the remit of the research. CDFA members provided permission to access data from their annual member survey (*Inside Out 2005),* which covered the period to September 2005. This provided in-depth data on target groups covered, products offered, terms of lending, portfolio performance and outputs. Credit Unions, including the largest in the region, were willing to share similar information where available.

The information collated through secondary research was supplemented by questionnaires on coverage and sustainability and by face-to-face and telephone interviews with managers of CDFI's and Credit Unions. This information was then analysed to provide a picture of financial inclusion services coverage in the South and of the gaps in that coverage in terms of target groups, products and geographical areas.

The CDFA *Inside Out* survey also proved invaluable in assessing the sustainability of CDFI's. Together with interviews with Portsmouth Savers and Brighton and Hove Credit Unions, it allowed the team to build up a picture of what has been achieved in terms of sustainability of providers and what could realistically be expected from different types of organisation serving different markets. Sustainability was considered across the primary dimension of operational sustainability, but also augmented by dimensions of mission-driven sustainability and structural sustainability.

Two focus groups were held in the region: in Portsmouth and Guildford a third meeting was held in London.The first meeting, held in London, focused on coverage and on the demand for financial services in the South-East, which is the subject of a parallel piece of research. The second meeting in Portsmouth looked at the sustainability of financial inclusion service providers. The final meeting in SEEDA's offices in Guildford reviewed the findings of the research to date and discussed the way forward.

Finally, the results of the analyses of coverage and sustainability were summarised in this report and strategic recommendations produced to demonstrate how SEEDA can use its leadership

role in economic development in the South East to facilitate the delivery of efficient and effective financial inclusion services, to increase the economic viability of employment, to tackle the culture of worklessness and to mitigate the economic costs of financial exclusion.

3. POLICY AND FUNDING CONTEXT

INTRODUCTION

The two core principles behind Government intervention in the field of financial exclusion are:

- Efficiency, and
- Equity.

Efficiency: Deprived areas, communities and communities of interest face multiple market failures in the supply of fair and appropriate financial services. The Competition Commission[1] has made a provisional finding on the home credit industry that the combination of the insensitivity of customers to prices and the failure of lenders to compete on price prevent, restrict or distort competition in that market. As a result, customers pay higher prices, resulting in an estimated loss of £26 per loan or, on a per capita basis over £13 million in the South East of England. For enterprise lending, market failure in the provision of finance is caused by information asymmetries, limited cash reserves and lack of collateral. Reaching US business start-up rates would result in an extra 1.9 million businesses in the UK, delivering almost 300,000 extra businesses in the South East.

Equity: SEEDA's Regional Economic Strategy is clear about the importance of building cohesive, sustainable communities. "Poverty and disadvantage exists in the South East, along with a strong economic performance. In order to be sustainable, prosperity and the quality of life which underpins it must be inclusive and give everyone the opportunity to…work, develop skills and engage in cultural life, to release untapped potential and help to build cohesive, sustainable communities."

FINANCIAL INCLUSION TASKFORCE

The Government set out its strategy to tackle personal financial exclusion in its paper, *Promoting Financial Inclusion*[2], published with the 2004 Pre-Budget Report. The report prioritised three areas:

- Access to banking;
- Access to affordable credit;
- Access to free, face-to-face money advice.

The Government also established a Financial Inclusion Fund of £120m over three years and a Financial Inclusion Taskforce, chaired by Brian Pomeroy, to oversee progress. The Financial Inclusion Taskforce was launched in February 2005. The Taskforce has supported the

[1] The Competition Commission, Home Credit Market Inquiry, Summary of Provisional Findings, 2006.

[2] HM Treasury, Promoting Financial Inclusion, December 2004

extension of the Community Investment Tax Relief scheme to cover personal lending as well as enterprise investment.

FINANCIAL INCLUSION FUND

The Financial Inclusion Fund is providing:

- £45 million to support an increase in provision of face-to-face money advice, administered by the Department of Trade and Industry. Fourteen bids for funding have been approved and will fund about 500 debt advisors. A joint bid between Citizens Advice and the independent advice sector for £1.2 million has been approved and will employ 12 advisors. It will cover Brighton and Hove, Hastings, Portsmouth, Southampton, North Hampshire, Slough, South Buckinghamshire, North West and East Kent and Milton Keynes and concentrates exclusively on social tenants. In addition, two national bids include parts of the South East. They are from Community Finance Solutions totalling £1.16m and including Portsmouth and a Citizens Advice bid for £2.24 million, which includes the Isle of Wight.
- £6 million being used by the Legal Services Commission to pilot money advice outreach approaches to those who do not normally approach debt advisors, focussing particularly on areas of high financial exclusion. The first four projects have been launched, but none are in the South East.
- £36 million for a growth fund to support the coverage, capacity and sustainability of CDFI's, Credit Unions and other third sector lenders. The deadline for applications was 3rd April 2006 and decisions on funding are awaited.
- Other funding totalling £33 million for broader financial inclusion objectives, improving the knowledge base of financial exclusion issues and administration.

ENTERPRISE FINANCIAL EXCLUSION

Financial exclusion in relation to enterprise, particularly in deprived communities has been on the government's agenda dating back to 1993 and a range of policies and initiatives have been introduced since then.

ENTERPRISE AND SOCIAL EXCLUSION

The first major report was prepared for Policy Action Team 3 which looked at the relationship between Enterprise and Social Exclusion and was published in 1993[3]. This report concluded that:

"Our single most important finding is simply that promoting enterprise in deprived communities does not get the attention it deserves - whether from the different parts of central government or from the diversity of local and regional institutions, or from private sector banks and other firms. There is more that can be done by all these parties towards goals that should be common - building communities with stronger local markets, and giving everyone with the potential to succeed in business the opportunity to do so."

[3] Enterprise and social exclusion, National Strategy for Neighbourhood Renewal: Policy Action Team 3

The conclusions go on to identify three big obstacles to enterprise in poor communities.

- not enough accessible, high quality business support - like advice and training on marketing and money;
- "market failures" in access to finance, which mean that not enough capital is available for projects with high returns to society;
- a weak culture of support for enterprise, across the whole range of local and national institutions.

The report made wide ranging recommendations and led to the incorporation of Enterprise in Disadvantaged Areas as an objective for the newly formed SBS. In relation to finance, the recommendations recognised firstly that the banks needed to be encouraged to do more to serve poor areas and secondly that innovation was needed in the delivery of appropriate financial services. The report also called on the government to recognise the social return on its own investments

"…The Government should also encourage new initiatives to provide finance for enterprise where justified by the high potential returns to society." The report recommendations went on to propose a new challenge fund for 'new financing initiatives'. This recommendation was made reality the same month with the launch of the Phoenix Challenge Fund designed to pump prime Community Development Finance Institutions.

Finally, the report was clear about the importance of self employment.

"it will be important to ensure that self-employment is clearly recognised and continues to be treated as a perfectly valid option that deserves support. The aim should be to make the move from "benefits to business" as natural and easy as the move from "welfare to work**".**

SOCIAL INVESTMENT TASKFORCE

The first report of the Social Investment Task Force was launched by its Chairperson, Sir Ronald Cohen, in October 2000. The five recommendations of the report were:

- The introduction of a Community Investment Tax Credit;
- The launch of a Community Development Venture Fund;
- Bank disclosure of lending in under-invested areas;
- Greater flexibility for investment in Community Development initiatives; and
- Support for Community Development Finance Institutions.

In response to the PAT 3 report, *Enterprise and Social Inclusion* and those recommendations, the Government introduced Community Investment Tax Relief, supported the launch of Bridges Community Ventures and funded the establishment and development of the Community Development Finance Association. In addition, in 1999 it launched the Phoenix Fund to encourage enterprise in disadvantaged communities and under-represented groups.

Only the third of these recommendations has not been delivered (bank disclosure). A number of banks including RBS/Natwest and Barclays publish limited data on their lending in disadvantaged areas. The Bank of England also reported on bank returns relating to lending in the poorest 5% of postcodes but no quality data at Super Output Area level, (similar to that available in the USA under the Community Reinvestment Act), has been made publicly available. Some specialist reports have been produced by the Bank of England covering lending to Black and Minority Ethnic businesses and to Social Enterprises.

PHOENIX FUND

The Phoenix Fund was launched in November 1999 to tackle issues of access to business support and finance. It ended activity in March 2006. The largest element was the Phoenix Development Fund which financed 95 business-support projects across England during its first three years of operation and 25 of these for a further 2 years. Its aim was to promote innovative ways of supporting enterprise in disadvantaged communities and under-represented groups.

The Phoenix Challenge Fund supported CDFI's providing loans for start-up and existing businesses and social enterprises, operating mainly in deprived areas and unable to access finance from mainstream providers. Between 2000 and 2006, the Phoenix Fund supported over 60 CDFI's with more than £42 million of grant. In the South East, four regional or local CDFI's were supported:

- Capitalise Business Support Ltd, covering East Sussex;
- Enterprise Loan Fund, covering North Kent
- Fredericks Foundation, covering Surrey, Hampshire, Berkshire, Sussex, Isle of Wight and Wiltshire
- Portsmouth Area Regeneration Trust (now South Coast Moneyline) covering Portsmouth, Fareham, Gosport, Havant and Isle of Wight.

In addition, five national and multi-regional CDFI's which were supported to operate in the South-East:

- BIGInvest
- Charity Bank
- Industrial & Common Ownership Finance (now Co-operative and Community Finance)
- PRIME
- Triodos Bank.

The Phoenix Fund also supported the establishment of a Community Venture Capital Fund, managed by Bridges Community Ventures Ltd, by investing up to £20 million on a pound-for-pound basis with private sector investors. The fund invests in viable SME's capable of sustained growth located in the 25% most deprived wards in England.

A Development Fund for Rural Renewal was added as a response to the foot and mouth crisis.

Finally, four pilot City Growth Strategies were supported in St Helens, Plymouth, London and Nottingham under the auspices of the Phoenix Development Fund with technical assistance funding for 2 years. City Growth Strategies (CGS) followed Michael Porter's model of building private sector led growth coalitions and encouraging them to focus on growth oriented local clusters. There were a number of second generation CGS pilots from 2004-2006. The 2004 Spending Review included a ring fenced allocation for the post Phoenix fund period of £17 million for 2006-8. This was made up of a number of elements:

- £6 million already committed to RDA single pots in two allocations of £3m based on RDA funding formula for 2006-7 for enterprise in disadvantaged communities. The funding formula means that the larger and needier RDAs such as London and the North West get the largest allocation to their single pots.
- £7 m in 2006 and £4m in 2007 are due to be passed on to RDAs to be spent on existing CDFIs. This £11m is less than historic spending by the Phoenix funding on England's CDFIs. This funding is confirmed but not yet allocated to budgets.
- Some top slicing for support to the Community Development Finance Association.

The end of the Phoenix Fund in 2006 has led to a reduction in funding available for specialist business support and for CDFIs. Some transition arrangements have been made for CDFIs although these were incomplete at the time of writing. This diminution of funding caused by the ending of the Phoenix Fund has been exacerbated by the reduction in other funding streams including Single Regeneration Budget which is in its final year and ERDF where the Objective 1, 2, Urban and Interreg programmes are in their last year of commitments. Some spend under current programmes will continue through to mid 2008.

A number of advocacy and technical support organisations for specialist forms of enterprise have been supported by DTI sometimes through the Phoenix Fund. Thus Prowess, the women's enterprise trade association and CDFA for community development finance were both supported by Phoenix Fund grants. This has led to some difficulties for these organisations when the fund ended in March 2006. The Social Enterprise Coalition is directly supported by DTI and is also rumoured to have suffered a cut in 2006. National BME groups gain support from a range of sources but were not supported directly by the Phoenix Fund.

LOCAL ENTERPRISE GROWTH INITIATIVE

The Government is currently implementing its proposals for a Local Enterprise Growth Initiative (LEGI) worth £50 million in 2006-07 and rising to £150 million per year by 2008-09. The aim of the LEGI is:

"to release the productivity and economic potential of our most deprived local areas and their inhabitants through enterprise and investment – thereby boosting local incomes and employment opportunities."

The objectives of the programme are:

- To increase local entrepreneurial activity among the population in deprived local areas;
- To support the sustainable growth – and reduce the failure rate – of locally owned business in deprived areas;
- To attract appropriate inward investment and franchising into deprived areas, making use of local labour resources.

It is intended that LEGI will continue for ten years subject to the Comprehensive Spending Review in 2007. Whereas the Phoenix Fund was delivered through the SBS as an agency of DTI the new initiative is to bypass all traditional enterprise routes including the RDAs and go through the Office of the Deputy Prime Minister (now renamed as the Department of Communities and Local Government) direct to Local Authorities. All of the Neighbourhood Renewal Areas are eligible to bid and LEGI can be seen as being a funded fourth 'economic' Pillar of the Neighbourhood Renewal strategies. In the South East these authorities are Portsmouth, Brighton, Hastings, Southampton and the Isle of Wight. Hastings was one of ten winners in the first round of awards that were announced in early 2006. Bids for the next round are due in September with announcements of winners later in the year. The South East can reasonably expect on the basis of statistical probabilities to have one further winner in the next round. However, there are no regional allocations as awards are based on merit.

THE REGIONAL ECONOMIC STRATEGY

The Regional Economic Strategy has been revised following extensive consultation during 2005 and was published in draft form prior to acceptance by central government in the Spring of 2006. It is structured around three objectives:

- Global competitiveness
- Smart Growth
- Sustainable Prosperity

Particular reference is made of the need in the less prosperous areas to raise the level of start up activity (page 23) while in more prosperous areas the survival rates should be higher.

In rural areas, the strategy refers to the implementation of new models of streamlined collaborative and flexible delivery in rural areas which recognises the diversity of rural communities and landscapes. On enterprise, the aim is to stimulate entrepreneurship and ensure that rural businesses have access to quality infrastructure including ICT, business advice, skills and training.

In the coastal areas there is reference to supporting business start ups and releasing the enterprise potential of creative and tourism industries and expand the cultural offer (page 20)

The majority of actions for enterprise are contained within the Smart Growth objective. Target 1 focuses on Enterprise and highlights the lower levels of start up and stocks of enterprise in the South East compared to other international comparators such as the United States. It notes that deprived parts of the region have lower numbers of business starts: 3.3 per 1000 compared to 4.9 in the best performing parts of the region. Women are under represented in business. Men are 2.4 times as likely to start a business as women.

Under the actions within the enterprise target (target 1) the following actions have relevance to CDFIs:

Table 1: RES Actions to which CDFI's and Credit Unions can contribute

Reference in RES	Action	Potential contribution of CDFIs and Credit Unions
15	Integrated approach to business support 'Joining Forced'	Organise referral and brokerage mechanisms for access to finance
16	Implement improved and better targeted support for women's enterprise	Market loan products to women entrepreneurs
17	Support new and growing businesses in the creative and tourism industries	Target marketing by CDFIs to these businesses most of which are micro enterprises
18	Stimulate enterprise in rural areas	Micro loans and also social enterprise lending
20	Support the development of home based businesses	Most home based businesses are micro businesses. CDFI's can provide a regionally packaged finance offering.
21	Expand enterprise gateways from 9 to 20 by 2009	Link CDFIs in to enterprise gateways
22	Create a permanent new early stage business fund (Finance South East)	This fund is targeted at loans over £50k. CDFIs could develop a new product at £7,500 - £25,000 to complement it.
23	Build sustainability and CSR into everyday business practice	CDFIs are the most sustainable part of the Business Support architecture because they

Reference in RES	Action	Potential contribution of CDFIs and Credit Unions
		have income from lending. CSR is part of the CDFI ethos.
25	Stimulate increased levels of enterprise among older people	Prime is mentioned in the RES but also other specialised lending including to social enterprises can support older people and enterprise.

JOINING FORCES

Joining forces is the alliance of business agencies and partnerships in the South East. It stems from the 2004 Budget in which the Chancellor announced that funding for Business Link would transfer to RDAs from 1 April 2005. SEEDA saw the opportunity to improve the alignment of business support services with the Regional Strategy and with three business led boards covering Science, Technology and engineering and Productivity. The new framework has been called 'Joining Forces' and represents an integration of skills and innovation support with business support activities. At the same time the new Business Link would be the main point of contact with businesses seeking advice through an information, diagnostic and brokerage service. There would be a separation of function between Business Link and the providers of specialist services that they would broker to. SEEDA decided to continue with separate contracting arrangements for six sub regions and did not go through the unification route that has taken place in other regions (e.g. emda with one contract, SWERDA with two).

The objectives of Joining Forces are to:

- make it easier for business to access advice and support
- increase take up of services
- increase numbers of referrals of customers between providers in all sectors improve service standards
- Integrate skills and innovation with business development.

Since taking over the Business Link SEEDA has established

- an agreed core regional Business Start Up offer, in collaboration with the Local Enterprise Agencies, Enterprise Hubs and Gateways,
- an agreed region-wide 'Access to Finance' service available through Finance South East,
- enhanced support for innovation in business underpinned by the new SEEDA Innovation Service which will make additional expert resource available to each BLO;
- the first regional marketing plan to increase take up of business support, starting with an advertising campaign from October 2005 (this is also an example of efficiencies that will be gained from the BLOs working together); and

- collaboration with the LSC on a regional Skills Advice Service to provide quality employer-focused brokerage services across the region that provides seamless access to skills, training and workforce development.

The Enterprise Gateways, which are planned to expand to 20 during the next RES Programme period, are an important infrastructural development and can play a crucial outreach role for CDFI's in supporting enterprise in deprived communities.

EUROPEAN POLICY ON FINANCIAL ENGINEERING

Financial Engineering or Risk Capital Financing is increasingly seen as an alternative to grant aid for the European Union. It is seen as beneficial to SME's which gain more equity capital to fund their business plans and for the economy as a whole, as SME's contribute to innovation, economic growth and job creation. The EU identifies the main sources of market failure in the supply of risk capital as imperfect and asymmetric information. State Aid and Risk Capital Guidelines view a number of aid instruments positively, to increase the provision of risk capital funding for SME's in their early growth stages in order to tackle the equity gap which affects them. However, this is conditional on compliance with State Aid rules, outlined in the EU's "Guide to Risk Capital Financing in Regional Policy."

EUROPEAN POLICY AND PROGRAMMES FOR MICROFINANCE AND SMALL BUSINESS LENDING

The European Commission and the European Investment Bank Group have launched a joint initiative to improve access to finance for micro to medium-sized enterprises. The initiative, called JEREMIE, will offer the chance to work with the European Investment Fund to improve capacity in the field of financial engineering. It will enable Member States and particularly Regions to use part of their structural funds through EIF to deliver financial products for micro, small and medium enterprises. The initiative will become operational in 2007. It will work through local financial intermediaries such as regional venture capital funds, banks, microfinance organisations and CDFI's.

Funding made available through JEREMIE must be used to provide financing to SME's making investments in fixed assets and long-term working capital. This may involve new projects or the modernisation or expansion of existing businesses within sectors such as manufacturing, agribusiness, environment, services, ICT, life sciences, etc

In addition, the following SME criteria apply:

- Eligible enterprises are SME's with a maximum of 249 employees, a maximum annual turnover of EUR 50 million and/or a maximum annual balance sheet of EUR 43 million.
- Preference should be given to small (< 50 persons; balance sheet/annual turnover < EUR 10 million) and micro enterprises (< 10 persons; balance sheet/annual turnover < EUR 2 million).
- Eligible SME's must have majority private ownership and control, or be in the final stage of the process of privatisation. They must not conduct business in the following activities: gambling, real estate, banking, insurance or financial intermediation and the manufacture, supply or trade in arms, or activities on EIF's or EIB's exclusion lists.

The framework for the JEREMIE initiative is the European Commission's next budget programming period, 2007-2013. 2006 is the Preparatory Phase, when Member States and the European Commission, with support from EIF, will identify the financial engineering needs in their respective regions for the financial period 2007 - 2013. This evaluation will form part of an action plan. JEREMIE has been designed both to support financial engineering products aimed at stimulating competitiveness as well as products such as micro finance that have a role in combating exclusion.

The Implementation Phase was due to be launched on 1st January 2007; when the JEREMIE initiative would enter into the implementation phase and would become operational. It is likely that these dates will slip by around six months due to the late approval of the EU budget and the knock-on effects that this will produce in approvals of European regional development programmes for 2007-13.

SUMMARY

The issues of enterprise and personal financial exclusion have come to the fore as policy priorities over the past seven years. However, the policy and funding landscape has changed and will continue to change dramatically over that period. At **national** level, Government first concentrated on developing a funding infrastructure for enterprise in deprived communities. Having kick-started the CDFI sector through the Phoenix Fund, funded the Community Development Finance Association, established Community Investment Tax Relief and supported research, training and best-practice development, responsibility for the 2006-08 Phoenix Fund has been transferred to **regional** level, through the RDA's.

The next stage of development will be the funding of selected **local** authorities through the Local Enterprise Growth Initiative to target enterprise support activities at the most deprived areas over a five to ten year time-frame. The transfer of engagement from national to regional and then to local level will add to pressures on small CDFI's to develop strategies to meet changing government priorities and SEEDA could play a very positive role in facilitating the development of common strategies to meet region-level priorities. This picture is complicated by the welcome introduction of JEREMIE, the European funding programme which is structured at regional level.

SEEDA can play a central role in co-ordinating strategy for personal and enterprise financial exclusion, by developing a regional funding framework covering the period of the Regional Economic Strategy, with initial commitments over a three year period. This could take advantage of the legacy funds from Phoenix, the Financial Inclusion Fund, the Local Enterprise Growth Initiative and European funding (ESF, ERDF and the European Investment Fund's JEREMIE Initiative), as well as SEEDA's own Single Pot resources.

SEEDA's influencing role could be utilised to form a High Level Group on Financial Inclusion in the Region, to include the major housing associations, local authorities and banks as well as representatives from CDFI's and Credit Unions. This group would be tasked with developing strategic solutions to financial exclusion and exploring new ways of bringing private sector finance into growing the sector.

SEEDA could also ensure that regional Business Link advisors broker appropriate clients to CDFI's in the Region and that Enterprise Gateways work closely with the CDFI's in their areas.

4. AVAILABILITY OF FINANCIAL SERVICES IN SOUTH EAST

INTRODUCTION

Financial exclusion is a problem for a small but significant minority of residents in the South-East of England, affecting roughly 616,000 people mainly in the 20% most deprived Super Output Areas in the Region. Although the issue of financial exclusion has become a government priority particularly in the last seven years, many of the types of organisations, such as Credit Unions and Citizens Advice Bureaux, which work to tackle the problem, have a long history of working to help people with financial difficulties. The Community Development Finance movement, which also includes personal finance organisations, concentrates in supporting enterprise and social enterprise particularly in deprived communities.

PERSONAL FINANCE SERVICES

Personal finance service providers include credit unions which offer savings accounts, loans, children's savings accounts as well as budgeting and debt advice. Leading Credit Unions in the Region are introducing new accounts similar to bank current accounts with cashcards as well as cash ISA's. Our surveys identified twenty credit unions working in the Region, of whom responses were received from fourteen. The other main personal finance provider in the South-East is South Coast Money Line (formerly Portsmouth Area Regeneration Trust), which is a CDFI and provides personal and micro-enterprise loans as well as advice and support.

The survey shows that of the 2,346 personal loans made in the South-East last year, over 2,000 of them were made by the top six providers. The ranking of providers in terms of number of loans is:

Table 2: Ranking of Personal Finance Providers by Scale

Ranking	Provider Name:	No. Loans
1	Portsmouth Savers Credit Union Ltd	863
2	South Coast Money Line	361
3	City of Brighton & Hove Credit Union	268
4	Isle of Wight Credit Union Ltd	250
5	Crawley Credit Union Limited	145
6	Isle of Thanet Credit Union Ltd	144
7	Hastings and St Leonards Credit Union Ltd	84
8	Medway Credit Union Limited	80
9	Central Sussex Credit Union	40
10	Southampton Co-operators Credit Union Ltd	38
11	Eastleigh Credit Union Limited	25
12	District of Canterbury Credit Union Limited	25
13	Family Assurance .. Employees CU	12
14	Oxford & District Credit Union Ltd	11
	TOTALS:	2,346

CASE STUDY 1:
PORTSMOUTH SAVERS CREDIT UNION
www.portsmouthsavers.co.uk

Portsmouth Savers Credit Union was established in 2001, with a common bond of those who live or work in the City of Portsmouth. It has been supported by a range of funders including SEEDA, the Neighbourhood Renewal Unit, Portsmouth City Council, the Portsmouth and South-East Hampshire Partnership and PHA Group.

In 2003, Portsmouth Savers joined the Association of British Credit Unions' (ABCUL) PEARLS project, using the World Council of Credit Unions (WOCCU) financial monitoring and business planning system to improve its performance. This project was funded by Barclays and the Office of the Deputy Prime Minister.

At the time that Portsmouth Savers started to introduce PEARLS, it had fewer than 1,000 members, operational sustainability level of 14% and grant income tapering off over the next three years. The Credit Union decided to abandon the traditional credit union link between savings and loans, to introduce capacity-based lending and to offer a fixed dividend of 4% on savings. They also moved to shop-front high street premises in Fratton Rd, Portsmouth.

Portsmouth Savers now has almost 4,000 members and has lent more than £2 million to local people. Its loan book currently stands at over £833,000 and its operational sustainability ratio has increased to 34%.

It offers a Benefits Direct Account for direct payment of government benefits. A range of savings products are on offer, including Standard Savings, Employee Savings (with direct deductions from wages/salaries), Plan & Save and a Christmas Savers Club. Young Savers Clubs operate in six local schools with more than 300 members. Portsmouth Savers' plans for future development include launching a current account with a cashpoint / debit card and a cash ISA product.

Portsmouth Savers' major capacity constraint is loan capital. It has demonstrated its innovative and business-focused approach to tackling financial exclusion by borrowing loan capital from CDFI's including Charity Bank (the Esmee Fairbairn Foundation Loans Programme) and Co-operative and Community Finance. However, in order to double its loan book, it needs access to £750,000 in loan capital.

In terms of the six credit unions and a small number of other potential providers not included in this table, every effort was made to contact them directly by phone and email and indirectly, with the help and support of ABCUL. One of the Credit Unions (Open University) is not a community-based credit union. It seems unlikely that the remainder are making more than twenty loans a year each, leaving the possible total number of loans at 2,500

Our parallel report, providing a baseline and mapping of financial exclusion[4] in the South-East, estimated that there is a potential demand in the South-East of 20,716 loans, which means that **12% of the potential demand is currently being served**. The table overleaf shows the local authorities ranked by scale of financial exclusion, which have some coverage, however limited, by personal finance providers. The providers highlighted in **bold** are those who provide over 85% of the personal loans in the South East.

The local authority areas which suffer from substantial levels of financial exclusion but have no service are:

- Slough
- Dover
- Shepway
- Gravesham
- Swale
- Arun
- Maidstone
- Ashford
- Adur.

In addition, there are a number of areas where a credit union or other provider is in existence, but is not managing to reach its target group by achieving more than 50 loans per year. These areas include Eastbourne, Milton Keynes, Oxford, Canterbury and Reading. Finally, in terms of coverage, the dispersed spatial characteristics of deprivation in the South East – an archipelago of poverty means that concentrations of poverty and social exclusion can be found in almost every district. Although these may not feature in the 20% most financially excluded, SOA's in some of the most prosperous areas such as E01004108 Sutton at No. 629 in the Financial Exclusion Index and E01002919 Kingston upon Thames at No. 726 are 60-80% above the median and are characterised in the Financial Inclusion Demand Report as severely financially excluded.

[4] Small Change Partnership, Financial Exclusion Baseline and Mapping, SEEDA 2006

Table 3: Personal Finance Coverage

LOCAL AUTHORITY AREA	CDFI / CREDIT UNION
Portsmouth	Portsmouth Savers, South Coast Moneyline
Hastings	Hastings and St Leonard
Thanet	Isle of Thanet CU
Slough	NO COVERAGE
Gosport	Portsmouth Savers, South Coast Moneyline
Southampton	Southampton Co-op, **South Coast Moneyline,** Sanctuary CU
Medway	Medway,
Dover	NO COVERAGE
Shepway	NO COVERAGE
Gravesham	NO COVERAGE
Swale	NO COVERAGE
Havant	Portsmouth Savers, South Coast Money Line with Havant Savers
Eastbourne	Eastbourne Community CU,
Milton Keynes	Milton Keynes CU
Brighton and Hove	Brighton and Hove CU
Oxford	Oxford and District CU
Canterbury	District of Canterbury CU
Reading	Proposed new
Rother	Hastings and St Leonard CU, Innovative Finance
Arun	NO COVERAGE
Crawley	Crawley CU
Isle of Wight	Isle of Wight CU
Maidstone	NO COVERAGE
Ashford	NO COVERAGE
Adur	NO COVERAGE

CASE STUDY 2:

SOUTH COAST MONEY LINE

www.scmoneyline.org.uk

South Coast Money Line (SCML) (originally Portsmouth Area Regeneration Trust) was the first Community Reinvestment Trust in England. Support for the start-up of the organisation was provided by Portsmouth Housing Association and Lloyds TSB. It operates in Southampton, Portsmouth, Gosport and Havant. Its main focus is on reaching the most financially excluded clients.

Since its inception, SCML has lent over £1 million to 1,442 individuals and 133 small businesses. The direct benefits of its activities include the creation or retention of 169 jobs and the establishment of 102 businesses. SCML staff spend approximately 20% of their time on advice and support for financially excluded clients. In terms of its client base, female clients take 64% of loans granted, with 36% going to single parents. 76% of loans go to benefits recipients, 24% have a criminal record, 10% have had drug or alcohol addiction problems and 49% have had one or more County Court Judgements in their name.

SCML has been particularly successful in building partnerships and a network of supportive agencies. This is demonstrated through the establishment of the Southern Home Loans Partnership, comprising South Coast Money Line, Portsmouth City Council, Brighton & Hove City Council, Eastleigh Borough Council, Chichester District Council and Gosport Borough Council. The Partnership has launched a new Home Improvement Loans Service to provide low cost loans to assist home owners to finance essential works to their properties. The loans are aimed at home-owners on low incomes or in receipt of means-tested benefits.

SCML's future plans are to consolidate its geographic expansion in Southampton and Gosport/Havant and to continue to launch one new area per annum to achieve an outstanding loan-book of over £4 million by 2009/10. Its proposed product range will include personal lending, home improvement loans, micro-enterprise loans and small business lending. Finally, SCML proposed to offer back-office services and training to other organisations across the country where, through economies of scale, they can be offered at lower unit cost.

MICROFINANCE

Microfinance is the provision of small-scale enterprise finance to the self-employed or very small businesses. The EU defines microfinance as referring to average loan sizes under €25,000 (approximately £16,000) and in the UK it refers to loans to enterprises with fewer than 10 employees, most frequently to the self-employed, sole traders and businesses with fewer than five employees.

Our study identified seven microfinance providers operating in the South East, of whom two are national organisations and four are sub-regional. In addition to access to finance, they provide a range of advice, support and sign-posting to other business services. The organisations are listed in order of the number of loans provided in the last financial period:

Table 4: Ranking of Microfinance Providers by Scale

	Microfinance Provider	No. Loans PA
1	The Prince's Trust	241
2	Fredericks Foundation	145
3	South Coast Money Line	64
4	Capitalise Business Support	45
5	Enterprise Loan Fund	36
6	Isle of Wight Lottery	6
7	Prime	1
	TOTALS	518

The Prince's Trust provides finance and support for under 30's on a national level and is providing the largest number of loans in the Region at 241. It is followed by Fredericks Foundation with 145 loans, which focuses its support on five groups of people: Financially Disadvantaged, Unemployed, Single Parents, Ex-Offenders and the Disabled. South Coast Money Line, covering Portsmouth, Havant, Gosport and Southampton which is the only CDFI operating in the region to provide personal and enterprise finance, made 64 enterprise loans in the past year, reaching the most financially excluded clients. Capitalise is a relatively new CDFI, just two years old, but has established itself well in Sussex and part of Kent. Enterprise Loan Fund has made 36 loans in Dartford, Gravesham, Medway and Swale. Full details of the derivation of the following statistics for enterprise financial exclusion are provided in Chapter 4 of the Financial Exclusion Baseline and Mapping Report produced for SEEDA in parallel with this report.

Table 5 below shows the estimated demand from start-up and existing micro-businesses (with under 10 employees in the South-East. The estimate is 9,089 loans per year and current providers are meeting 5.7% of that demand.

Table 5: Estimated Enterprise Financial Exclusion in South-East

Estimated total businesses	Estimated businesses refused finance	% Refused Finance	Start-up CDFI-viable	Micro CDFI-viable	Total Micro CDFI-viable
595,899	77,336	12.98%	3,596	5,493	9,089

Table 6 below shows the potential demand in the fourteen local authorities with the highest numbers of start-up and existing micro-businesses. The only areas currently covered by CDFI's are Medway and Brighton and Hove, although the latter area is covered by Capitalise which is severely short of loan capital.

Table 6: Estimated Enterprise Financial Exclusion in South-East in most Entrepreneurial Areas

LA Name	Estimated total businesses	Est. businesses refused £	% Refused Finance	Start-up CDFI-viable	Micro CDFI-viable	SB CDFI-Viable	Total CDFI-viable
Brighton and Hove	16866	2403	14.25%	127	151	7	286
Wycombe	16370	2044	12.49%	89	152	9	250
Milton Keynes	14847	2016	13.58%	100	133	9	242
Aylesbury Vale	15048	1893	12.58%	84	142	5	232
Windsor /Maidenhead	14599	1903	13.03%	89	135	7	231
West Berkshire	14399	1819	12.64%	81	133	8	222
Wealden	13832	1689	12.21%	71	132	5	208
South Oxfordshire	13278	1657	12.48%	73	125	6	203
Elmbridge	12487	1650	13.21%	79	115	5	200
New Forest	12924	1627	12.59%	72	120	6	199
Waverley	12487	1630	13.06%	77	115	6	198
Wokingham	12086	1608	13.31%	78	111	5	194
Medway	11307	1524	13.48%	75	103	6	183
Guildford	11613	1502	12.94%	70	108	5	183

CASE STUDY 3:

FREDERICKS FOUNDATION

www.fredericksfoundation.org

Fredericks Foundation was established in 2000 by Paul Barry-Walsh, a leading technology entrepreneur, in memory of his grandfather, Frederick Kerr. The charity focuses its support on five groups of people: **F**inancially Disadvantaged, **U**nemployed, **S**ingle Parents, **E**x-Offenders and the **D**isabled.

As well as providing low interest loans (base + 2%), Fredericks Foundation provides business mentoring, using volunteer mentors, marketing support, sales advice and skills and a range of advice services.

Fredericks Foundation has been one of the fastest-growing micro-enterprise CDFI's in the UK, having lent over £1 million to 450 clients since inception. In addition, it has provided advice and support to over 2,300 beneficiaries. 71% of its clients suffer from financial hardship. 97% were unemployed before they started their business. 13% are single parents, 12% are ex-offenders and 39% have a disability.

Fredericks Foundation's innovations are focused on two main areas. Firstly, they have specialised in working with particularly challenging target groups. For example, Fredericks Foundation works with National Health Trusts in London to provide enterprise start-up support for people who have suffered from mental illness.

Secondly, Fredericks has developed a very different sustainability model, using the private sector contacts and experience of the Founder, Paul Barry-Walsh and Chief Executive, Joe Michel. Fredericks Foundation is a charity with a subsidiary company limited by guarantee, Fredericks Services Ltd. This company provides IT services to other charities, with two self-employed staff providing sales and technical support. In addition, the Friends of Freds initiative has recruited 15 companies to date which donate 1% of their net profits per annum. Fredericks' fundraising initiatives include the Hannibal Challenge, a two-day walk over the Alps to raise money through sponsorship. Overall, the Foundation's aim is to raise 50% of its funding through commercial and charitable sources.

Fredericks Foundation aims to cover the South-East of England and London, eventually expanding nationwide, providing its support to particularly disadvantaged entrepreneurs.

Table 7 below focuses on the most financially excluded areas of the Region. It shows coverage in the most financially excluded local authorities and may give an unfairly positive picture of coverage in terms of enterprise financial exclusion. Prince's Trust covers the whole region and therefore ensures that young people under the age of 30 receive good advice and support services as well as access to finance. Prime was established to provide a similar service for people over the age of fifty, but has not yet made an impact in terms of delivery (1 loan last year).

Table 7: Coverage Gaps in the Most Financially Excluded Local Authority Areas:

LOCAL AUTHORITY AREA	CDFI
Portsmouth	South Coast Moneyline, Prince's Trust, Fredericks
Hastings	Capitalise, Prince's Trust, Innovative Finance, Fredericks
Thanet	Enterprise Loan Fund, Prince's Trust
Slough	Prince's Trust, Fredericks
Gosport	South Coast Moneyline, Prince's Trust, Fredericks
Southampton	South Coast Moneyline, Prince's Trust, Fredericks
Medway	Enterprise Loan Fund, Prince's Trust
Dover	Prince's Trust
Shepway	Capitalise, Prince's Trust
Gravesham	Enterprise Loan Fund, Prince's Trust
Swale	Enterprise Loan Fund, Prince's Trust
Havant	South Coast Moneyline, Prince's Trust, Fredericks
Eastbourne	Capitalise, Prince's Trust, Fredericks
Milton Keynes	Prince's Trust
Brighton and Hove	Capitalise, Prince's Trust, Fredericks
Oxford	Prince's Trust
Canterbury	Enterprise Loan Fund, Prince's Trust
Reading	Fredericks Foundation, Prince's Trust
Rother	Capitalise, Prince's Trust, Fredericks
Arun	Capitalise, Prince's Trust, Fredericks
Crawley	Capitalise, Prince's Trust, Fredericks
Isle of Wight	Isle of Wight Lottery, Prince's Trust, Fredericks
Maidstone	Capitalise, Enterprise Loan Fund, Prince's Trust
Ashford	Capitalise, Enterprise Loan Fund, Prince's Trust
Adur	Capitalise, Prince's Trust, Fredericks

Financially excluded areas which have no enterprise coverage for over 30's include:

- Dover
- Milton Keynes
- Oxford.

Enterprise Financial Exclusion in South-East by LA

Copyright (c) Experian Limited, Navteq 2005

Other, better-off areas without coverage include Buckinghamshire, South Kent, parts of Hampshire and Oxfordshire. There is a serious market gap in the North of the Region affecting Milton Keynes in particular and also Oxford. It seems likely that with the expansion of Milton Keynes/South Northamptonshire, the market potential for a CDFI in the area will grow. Given the serious levels of deprivation in Corby the potential for a CDFI crossing regional boundaries should not be ruled out. These areas are illustrated by the Enterprise Financial Exclusion Map on the previous page.

Within the enterprise lending sector, Prince's Trust is a dynamic national player with the potential for steady growth in its loan portfolio. At sub-regional level, South Coast Money Line, Fredericks Foundation and Capitalise all look capable of growing significantly if appropriate funding arrangements can be organised at regional level. Enterprise Loan Fund is not currently employing lending staff but has the infrastructure to provide coverage in the Greater Medway area.

There is likely to be some overlap as some of the larger players grow into adjacent territories and some competition between the regional and national players. Our suggestion is that in the first instance, the sub-regional players should attempt to enlarge the spatial coverage on their core markets without entering into direct competition with the other CDFI's. This would appear to be justified because all of the sub-regional organisations are dependent on public funding. Because of the specific market specialisms that are being developed – for example South Coast Money Line's home improvement loans and Fredericks Foundation's work with micro-entrepreneurs who have suffered mental illness – it is possible that in some product areas, there will be considerable spatial overlap but without having direct competition between products.

Where there are overlaps in coverage, it is likely that CDFI's can offer a form of stepped offer where one lender makes the first and perhaps riskiest loan and then graduates the lending to other, larger CDFI lenders and finally to the banks.

In terms of products, there is a notable absence, with the exception of the Fredericks Foundation, of specially targeted provision or marketing effort. No specialised marketing or product design is used to reach the specialist sectors that the Government and SEEDA have been keen to help into the labour market. These include products targeted on women, ethnic minorities, recent migrants and people with disabilities.

MICRO / SMALL BUSINESS LENDING

The average enterprise loan size from the six lenders is £3,555 and ranges from £7,500 (Capitalise) down to £910 (South Coast Money Line). South East Community Loan Fund offers loans ranging from £15,000 to £50,000 to incorporated SME's in the 20% most deprived wards in the Region. The average loan size is expected to be £25,000. CDFI SME lending in the UK amounts to 9.4% of portfolio value at almost £5 million, although this is concentrated in a small number of regions.

This implies that there is a small market gap in the South East for borderline micro/ SME lending including to businesses in deprived areas. There is an opportunity for the six sub-regional lenders to co-operate in providing a regional small business loan product in the range £7,500 to £20,000, averaging £15,000. This will increase investment in deprived communities while strengthening CDFI sustainability.

The table overleaf shows the estimated demand for this type of lending by local authority area:

Table 8: Estimated Micro / Small Business Lending Demand

LA code	LA name	Estimated Micro / Small Business Lending Demand
00ML	Brighton and Hove	7
11UF	Wycombe	9
00MG	Milton Keynes	9
11UB	Aylesbury Vale	5
00ME	Windsor and Maidenhead	7
00MB	West Berkshire	8
21UH	Wealden	5
38UD	South Oxfordshire	6
43UB	Elmbridge	5
24UJ	New Forest	6
43UL	Waverley	6
00MF	Wokingham	5
00LC	Medway	6
43UD	Guildford	5
29UH	Maidstone	6
45UF	Horsham	5
45UG	Mid Sussex	5
24UB	Basingstoke and Deane	6
38UB	Cherwell	6
29UK	Sevenoaks	5
24UC	East Hampshire	5
43UF	Reigate and Banstead	4
45UD	Chichester	5
11UC	Chiltern	3
24UP	Winchester	5
00MS	Southampton	6
29UQ	Tunbridge Wells	4
38UF	West Oxfordshire	5
38UE	Vale of White Horse	4
24UN	Test Valley	5
45UC	Arun	4
00MC	Reading	6
29UB	Ashford	4
24UD	Eastleigh	6
00MR	Portsmouth	5
43UE	Mole Valley	3
29UP	Tonbridge and Malling	5
11UE	South Bucks	3
24UG	Hart	3
43UK	Tandridge	3
29UM	Swale	4
43UJ	Surrey Heath	3
00MA	Bracknell Forest	4
29UC	Canterbury	4
00MW	Isle of Wight	4
43UM	Woking	4

LA code	LA name	Estimated Micro / Small Business Lending Demand
00MD	Slough	6
24UE	Fareham	4
38UC	Oxford	5
43UH	Spelthorne	3
43UG	Runnymede	3
21UG	Rother	2
21UF	Lewes	3
24UH	Havant	3
29UN	Thanet	3
29UL	Shepway	2
45UH	Worthing	3
29UD	Dartford	3
29UE	Dover	3
24UL	Rushmoor	3
29UG	Gravesham	2
43UC	Epsom and Ewell	2
45UE	Crawley	3
21UC	Eastbourne	2
21UD	Hastings	2
45UB	Adur	2
24UF	Gosport	1
	Totals	292

CASE STUDY 6:

CAPITALISE BUSINESS SUPPORT

www.capitalise.org

Capitalise Business Support is a subsidiary of Ten Sixty Six Enterprise, which is both the local enterprise agency for Hastings and Rother and the Chamber of Commerce for Hastings and St Leonards. It is still in its early start-up phase, as it was established in April 2004. Its original loan fund of £740,000 was funded by the Phoenix Fund (£500,000), the Single Regeneration Budget for Hastings (£150,000) and the Rural Regeneration Fund (£90,000). This has been further extended with funding from Area Investment Frameworks (AIF) funding over the next two years. Revenue support has come from Phoenix, Business Link, Leader +, SRB and local authorities but again has been bolstered with AIF funding. Capitalise originally launched to cover East Sussex, expanded last year to cover the whole of Sussex including the Unitary Authority of Brighton & Hove and has recently expanded again into the Maidstone, Ashford and Shepway Districts of Kent.

To date, Capitalise has received 575 enquiries to the end of May 06 (now averaging 30 per month). It has provided business-planning advice and signposting to other advice providers for 210 businesses and has disbursed 45 loans, averaging over £7,000. The total disbursed to date is £323,000. Capitalise lends to micro, small and medium-sized enterprises and to social enterprises for start-up costs, to purchase assets, to assist with growth and expansion or for gap-financing. Loan amounts range from £3,000 to £25,000 for terms from six to sixty months. Interest rates for loans under £10,000 are 14.75% APR, reduced to 13.25% for larger loans. All loans carry an administration fee of 2% or a minimum charge of £80. The organisation has successfully partnered mainstream & third sector providers, including the Prince's Trust and Fredericks Foundation.

The structure of Capitalise Business Support provides more stability for the organisation than if it were a stand-alone organisation. It is registered as a Company Limited by Guarantee and its controlling party and parent undertaking is Ten Sixty Six Enterprise, a Company Limited by Guarantee. It benefits from the expertise and networks of its parent organisations and from the capacity to share services, such as book-keeping and accounting. This should enable it to keep costs low while increasing deal-flow. Capitalise is able to offer free business advice and support for clients with the help of Ten Sixty Six Enterprises in the Hastings and Rother area or through other Enterprise Agencies and Gateways across the remainder of Sussex & Kent.

SOCIAL ENTERPRISE FINANCE

The main social enterprise CDFI's in the South-East are:

- Co-operative and Community Finance (formerly ICOF)
- Charity Bank
- Local Investment Fund / South East Community Loan Fund
- BIGInvest
- Triodos Bank.

In addition, Capitalise have made two social enterprise loans and Innovative Finance and Enterprise Loan Fund have had a product on offer, although have not had any take-up. Further analysis will concentrate of the "Big Five" above.

All five organisations operate nationally. Triodos and Charity Bank are licensed banks. All provide a wide range of tailored financial products, but with some elements of specialisation. Triodos Bank is known for its environmental lending. Co-operative and Community Finance has its roots in the co-operative movement but lends to both co-operatives and social enterprises. Charity Bank has particular expertise in lending to charities and voluntary organisations. LIF has developed regional specialisations through partnering with regional organisations such as Finance South East. BIGInvest includes a fund aimed at faith-based communities and organisations.

As these are national organisations, only LIF/SE Community Loan Fund has provided a regional breakdown of its loans. LIF has made 6 loans in 2005/06 totalling £400,000. However, from discussions with most of the other providers and the opportunity to review their national lending figures, our estimate is that roughly 21 CDFI social enterprise loans were made in the South-East in the last financial year. This is less than one-third of what might be expected in the South-East on a pro-rata basis and a tenth of the estimated total demand in the Region.

It is clear that there is neither a shortage of social enterprise finance providers nor of capital for lending. The particularly low performance in the South-East seems due to a combination of reasons. These include the perception among the sector that the Region is relatively prosperous and therefore not a priority area. Also, social enterprises in the South-East are significantly less likely to be involved in real estate or property rental, sectors which often drive borrowing. They also have fewer full-time employees and are therefore likely to have less management resource to develop new enterprises or projects that require funding.

There does not appear to be any gap in market for social finance in the South-East that cannot be filled by current providers.

WHOLESALE PROVISION

All five of the large social enterprise lenders, BIGInvest, Charity Bank, ICOF, LIF and Triodos, are accredited by the Small Business Service to use Community Investment Tax Relief and can wholesale funds for onlending to other CDFI's. Both Charity Bank, on behalf of the Esmee Fairbairn Foundation, and Co-operative and Community Finance have provided wholesale funds to Portsmouth Savers Credit Union to increase their available loan capital. Wholesaling money in this way brings a private sector discipline to CDFI's and forces the development and transparency of financial and social reporting systems. While smaller CDFI's may require some capital grants in particular where they are extending their operations into new areas or products, it is important that neither grants nor soft loans damage this developing capital market for CDFI's.

CASE STUDY 4:
BIGINVEST: CAPITAL FOR COMMUNITIES
www.biginvest.co.uk

BIGInvest is a national retail and wholesale CDFI and a subsidiary of The Big Issue. It brings together:

* Shorebank Advisory Services, a subsidiary of Shorebank Corporation, the oldest and largest US CDFI;
* The Big Issue, the UK's best known social business;
* Bank of Scotland Community Banking.

Its mission is:
"to encourage business-like responses to social problems by strengthening, growing and telling the stories of the community development finance and social enterprise sectors throughout the UK."

It provides access to finance directly to social enterprises and also wholesales money and provides capacity-building support to CDFI's. It is accredited for Community Investment Tax Relief as a wholesale and a retail CDFI. It lends between £50,000 and £250,000 itself and can broker access to larger loans. BIGInvest currently has access to a "general" loan fund of £3.5 million and a specialist loan fund of £10 million, aimed at faith-based communities and organisations.

BIGInvest received its funding in 2004 and began lending in 2005. It is already operationally sustainable, having lent a total of £2.7 million to social enterprises and CDFI's. BIGInvest has used its substantial international and banking experience to pioneer innovative approaches to lending, particularly in terms of quasi-collateral. For example, its CDFI loans range from £50,000 to £200,000 and are structured to meet the needs of the institution. Repayments and renewals are based on the underlying performance of the CDFI.

BIGInvest is one of four CDFI's which wholesale funds to other CDFI's and Credit Unions in the South-East. It demonstrates that wholesale funds are widely available in the region using a combination of start-up grant support and access to private capital, using a sustainable business model.

5. GAP ANALYSIS

Having reviewed the provision of financial inclusion services in the South-East by Credit Unions and CDFI's, we are now in a position to summarise the gaps in that provision – geographical coverage gaps, product gaps and group or community gaps.

COVERAGE GAPS

In terms of scale, the major coverage gap in financial inclusion services is in the area of personal finance. At present, 12% of the potential demand of over 20,000 fair finance loans is being supplied by existing providers. Of the 2,500 loans being provided, 85% come from the six largest organisations, five credit unions and one CDFI. These organisations need to scale up their operations substantially to meet the unmet demands for service, as Portsmouth Savers, South Coast Money Line and Brighton and Hove have shown that they can do.

In terms of micro-enterprise lending, an estimated 5.7% of the 9,089 loan demand is currently being met. The six enterprise lenders need to increase their scale of operation significantly, both to meet demand and to move towards sustainability.

The main coverage gap in the provision of enterprise financial inclusion services is in the gap between micro and small business lending. There is a gap in the market for loans between £7,500, which existing CDFI's are providing and £20,000 plus, which are provided by the South East Community Loan Fund, in disadvantaged areas. While the market is not huge, it would best be served by a joint approach by all six enterprise CDFI's offering a standard loan product to businesses across the region. This would require both access to loan capital and the development of standard loan application and analysis processes.

At the outset, it is obvious that there is no gap in the provision of social enterprise finance in the Region, but that work is needed to develop confidence and skills in a relatively weak market. Rather than increasing grant aid directly to social enterprises or indirectly through finance providers, investment could be made in education and business support for the sector so that it becomes more ambitious and professional in its social enterprise operations.

GEOGRAPHICAL GAPS

In terms of personal financial exclusion services, there are significant geographical gaps in some of the most financially excluded and deprived areas in the South-East. These are:

- Berkshire: Slough
- Kent: Ashford, Dover, Shepway, Gravesham, Maidstone, Swale
- West Sussex: Arun Adur

In Eastbourne, Milton Keynes, Oxford, Canterbury and Reading, the credit unions in existence have not yet managed to make a significant impact in terms of numbers of members or loans. Finally, there are small pockets of extreme financial exclusion in almost every district. The relatively small numbers of people involved and their geographical concentration means that this is a problem which can be solved by a concentrated and focused partnership by local authorities, housing associations, banks and building societies, credit unions and CDFI's, co-ordinated in a Regional Financial Inclusion Framework by SEEDA.

For microfinance concentrating on financially excluded areas, there are gaps in provision in Slough, Dover, Milton Keynes and Oxford. There are also significant underserved markets in the more prosperous areas such as Wycombe, Aylesbury Vale, Windsor and Maidenhead, West Berkshire, Wealden, South Oxfordshire, Elmbridge, New Forest, Waverly, Wokingham and Guildford.

There is no geographical gap in social enterprise lending or wholesale lending to CDFI's or Credit Unions for onlending. Some investment readiness work is likely to be needed with the region's social enterprises to prepare them for loan finance.

PRODUCT GAPS

Leading credit unions such as Portsmouth Savers in the region and others nationally are pioneering the development of products new to the credit union movement. These include a bank-style current account with cashcards and Cash Individual Savings Accounts. Brighton and Hove Credit Union is developing a range of differentiated loan products. Both of these credit unions have moved from traditional credit union products to develop new services designed around their clients' needs and wants. Their successes in growing credit union membership, (to almost 4,000 in the case of Portsmouth Savers) shows that client-centred innovation can lead to success in tackling financial exclusion. It is difficult for smaller credit unions to innovate, but co-operation through ABCUL could ensure roll-out of new services in smaller financial inclusion providers across the region.

Home contents insurance is one of the financial products from which a substantial number of households (9.9%) are excluded. The National Housing Federation has prioritised financial inclusion as one of its five policy themes. It is working on the provision of a low or no-cost home contents insurance service for its members' tenants. By including the National Housing Federation in its high level regional group for financial inclusion, SEEDA can ensure that the benefits of this proposal are fully realised in the South-East.

South Coast Moneyline is pioneering a home improvements loan product in partnership with Portsmouth City Council, Brighton & Hove City Council, Eastleigh Borough Council, Chichester District Council and Gosport Borough Council. The Partnership has launched a new Home Improvement Loans Service to provide low cost loans to assist home owners to finance essential works to their properties. The loans are aimed at home-owners on low incomes or in receipt of means-tested benefits. Innovators should be supported and encouraged to develop their new services to a stage where they can be provided on a regional basis.

As outlined above, there is a gap for a micro-small business loan product across the whole region. This loan would average £20,000 and could be provided by a partnership between the six existing providers.

GROUP OR COMMUNITY GAPS

In terms of products, there is a notable absence, with the exception of the Fredericks Foundation, of specially targeted provision or marketing effort. No specialised marketing or product design is used to reach the particular sectors that the Government and SEEDA have been keen to help into the labour market. These include products targeted on women, ethnic minorities, recent migrants and people with disabilities. These loan products need not necessarily be self contained funds for these groups. Work by Prince's Trust funded by the Phoenix Fund on increasing participation by young women in their programmes has shown that large scale programmes can increase their outreach to specific groups by distinctive marketing approaches.

CASE STUDY 5:

CHARITY BANK

www.charity-bank.org

Charity Bank was launched in October 2002 at 11 Downing St. It has pioneered a philanthropic banking model, as a registered charity with a full banking licence. Its shareholders include charitable trusts, foundations and Barclays Bank. Its depositors are individuals, companies, charities, churches and other institutions. It uses its deposits to provide loans to organisations with charitable purposes. Most of its borrowers are small to medium-sized charities, voluntary groups and social enterprises, working with marginalised communities or located in underserved areas. It has won the 2005 ifs/Deloitte Financial Innovation Award and the 2005 Charity Times UK Financial Services Award. It is based in the South East, with its head office in Tonbridge, Kent.

Since its launch, Charity Bank has lent £22 million in 227 loans averaging £97,400. It has increased its capital base to over £50 million, primarily through Community Investment Tax Relief. It also offers a range of savings and investment accounts. Its CITRA Account offers 25% tax relief over 5 years, plus up to 2% interest which can be donated to charity.

Charity Bank's charitable model means that it provides help and advice for organisations unsure about their investment-readiness.

Charity Bank clients in the South East include the Brighton-based celebratory arts company Same Sky, which works across the South East to create participatory and public arts projects. It has borrowed to refurbish the old Post Office in Kemp Town, Brighton and to ease cash flow difficulties caused by delays in receiving grant aid.

Charity Bank is the lead partner in the £125 million Futurebuilders England investment fund. It has made four investments to date in the South-East Region. These are Queen Alexandra Cottage Homes, the Chiltern Centre for Disabled Children, Pie Factory Music and Sector Services. The organisation also manages the Esmee Fairbairn Foundation's loan programme, which was an innovative development of Programme Related Investment for charities. Among its clients in the South East is Portsmouth Savers Credit Union which borrowed £50,000 to increase its loans fund and its progress towards sustainability.

6. SUSTAINABILITY OF EXISTING PROVIDERS

WHAT IS SUSTAINABILITY

In terms of tackling financial exclusion, sustainability can be defined as the extent to which interventions can be maintained by structures and institutions. CDFI's and credit unions are social enterprises, balancing their mission and their business activities. They maintain a balance or a creative tension between running an efficient enterprise and staying true to their social goals. Within that broad view of the sustainability of financial inclusion service providers, we can distinguish three different types of sustainability;

Operational Sustainability: the extent to which the organisation can pay for its operating costs out of earned income (for example from interest income)

Mission-Driven Sustainability: the extent to which the organisation can raise money from government or other stakeholders by demonstrating social impact

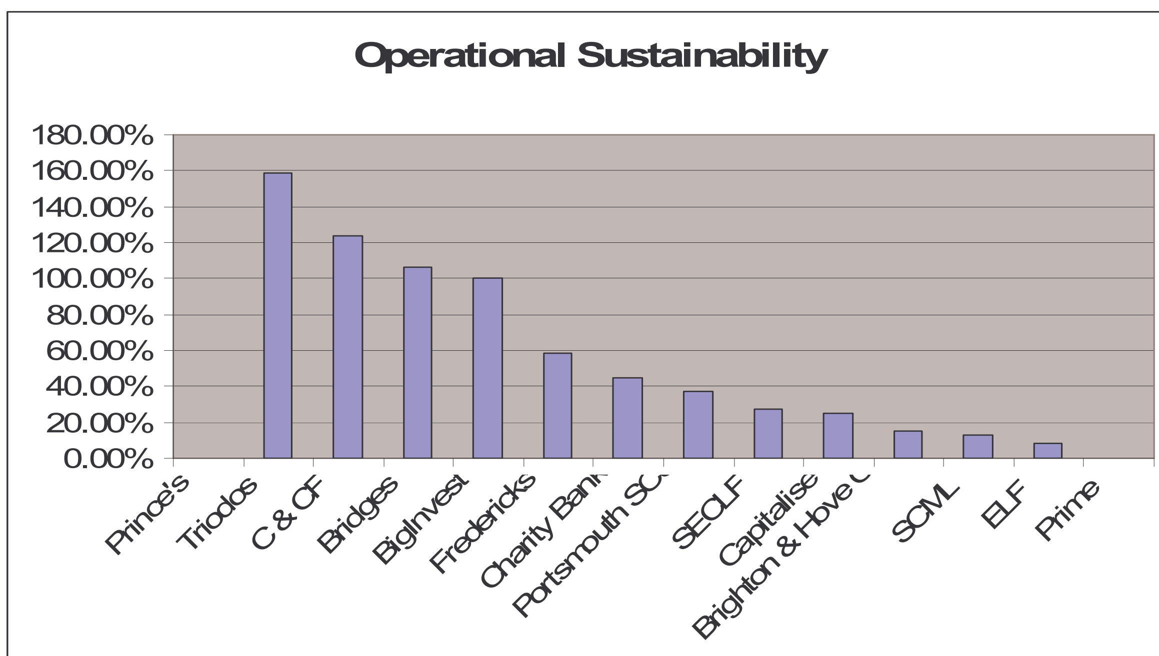
Structural Sustainability: the extent to which the organisation can raise money to pay for the cost of operations because of its structure (e.g. through fund raising or cross subsidy from a more profitable venture)

Many CDFIs and Credit Unions use a mixture of these three sources of revenue in order to balance their books. The three approaches are described in more detail below.

OPERATIONAL SUSTAINABILITY

Operational sustainability is achieved if a CDFI or Credit Union can cover its operational expenses from its income generated, normally from the interest income gained from its loan portfolio. The Operational Sustainability Ratio is the percentage of operating costs covered by earned income. Of those CDFI's which reported the ratio in the CDFA's *Inside Out* survey 2005, average operational sustainability was 36.1% although this covered a wide range from a low of 0.22% to 123%. Nearly half of CDFI's who reported had ratios of less than 20%.

Of the twelve CDFI's and two large CU's operating in the South East, operational sustainability ratios were obtained for thirteen (excluding Princes Trust). They ranged from 0% for Prime, which under its funding agreement, nets off all interest earned against revenue grant received to 158% for Triodos. Four of the CDFI's achieved full operational sustainability; Triodos, Co-operative and Community Finance, Bridges Community Ventures and BIGInvest. Three of these are social finance organisations and the fourth is a national community venture capital fund. Of the remaining organisations, sustainability levels ranges from 8.6% for Enterprise Loan Fund to 58.3% for Fredericks Foundation.



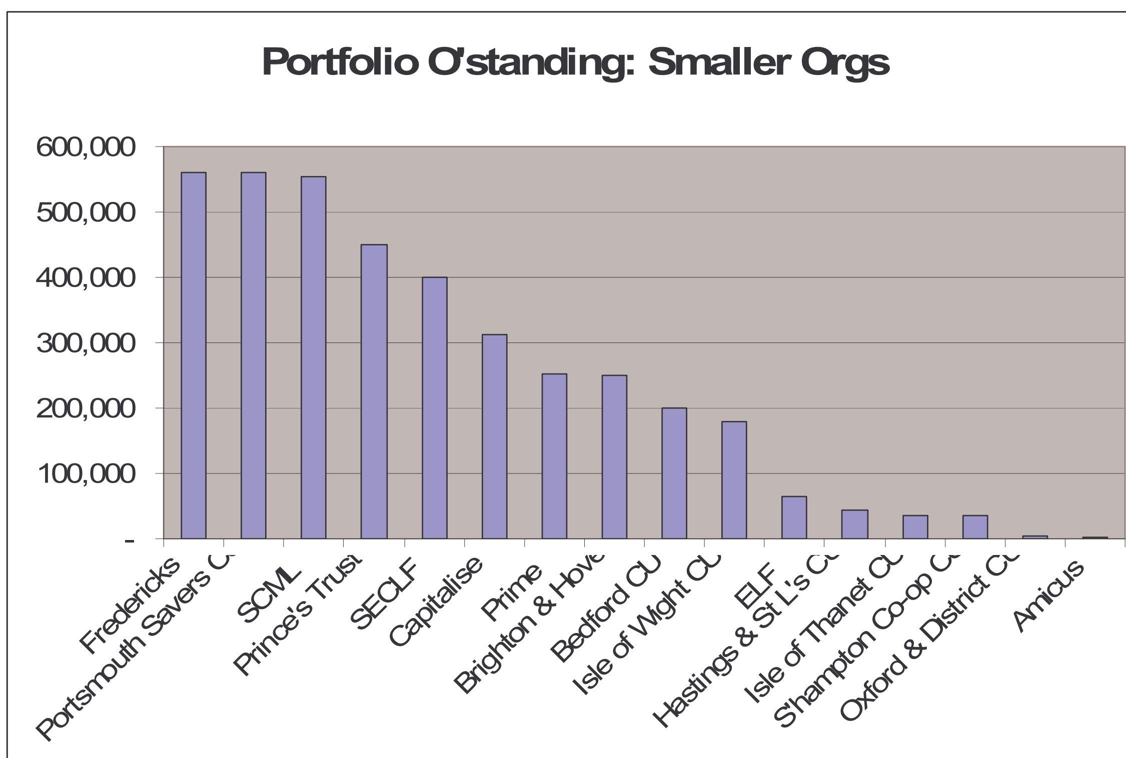
The smaller credit unions were not in a position to provide sustainability information, but information on their loan numbers indicate that they can only operate either on a small scale based on volunteer labour or if they receive a grant assistance to employ staff.

SUSTAINABILITY INFORMATION

Looking behind those statistics, we can see a clear picture in terms of the relationship between average loan or investment size and term, portfolio outstanding and sustainability. The largest average loan or investment size is £416,783 by Triodos Bank, followed by Bridges Community Ventures at £347,727. In comparison, eight of the CDFI's and Credit Unions make average loans of under £1,000. In terms of portfolio outstanding, the amount ranges from Triodos at the top again with £110,251,540 through four organisations with over £1 million to tiny credit unions with less than £10,000 outstanding. The top four organisations in terms of portfolio outstanding are:

Organisation	Portfolio Outstanding
Triodos Bank	£110,251,540
Bridges Community Ventures	£19,000,000
Charity Bank	£10,200,000
Co-operative & Community Finance	£1,700,000

The chart below shows the range of figures for portfolio outstanding for the smaller CDFI's and Credit Unions:



The pattern is of one community venture capital and four social enterprise lenders who are either fully operationally sustainable or are well on track to reach operational sustainability following a well-developed business strategy. Then there are five CDFI's and one Credit Union with portfolios' outstanding of over £300,000 and operational sustainability levels of between 20% and 60%. The graph shows a further nine organisations which were able to supply information, with portfolios outstanding of less than £300,000 and operational sustainability levels below 20% or unavailable but unlikely to reach higher levels.

The conclusion is that social enterprise lending, usually carried out at super-regional levels, is a sustainable operation based on large average loan sizes, relatively long loan terms and traditionally low write-off rates. Neither enterprise lenders nor personal lenders have achieved more than 60% operational sustainability and that figure was achieved, not from loan income but from commercial and charitable activities (Fredericks Foundation). The highest levels achieved in terms of loan interest income are just under 40% (Portsmouth Savers CU). In the section on Sustainability Models, the report will review whether personal lending, microfinance and enterprise lending to large micro-enterprises or very small businesses can ever be sustainable.

MISSION-DRIVEN SUSTAINABILITY

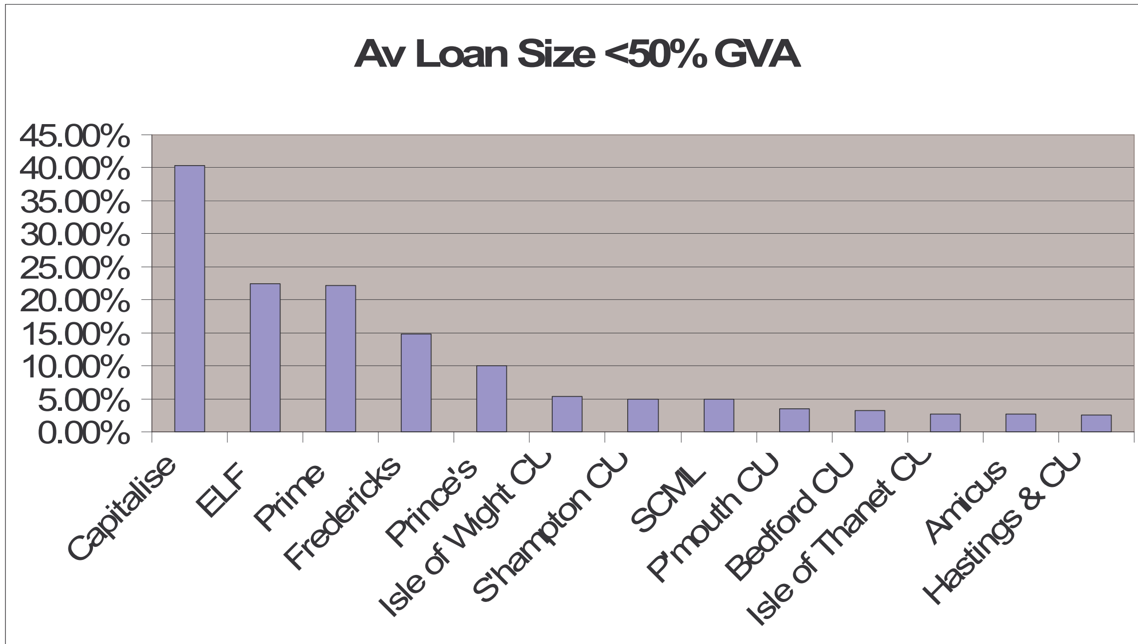
Mission driven sustainability is similar in concept to Social Return on Investment (SROI). SROI attempts to quantify the social returns of intervention by monetarising all of the values of benefits and disbenefits. SROI values of more than one achieved by a project suggest that there is a public interest to intervene. For financial intermediaries such as CDFIs and Credit Unions a lower operational sustainability may well be justified because their lending operations are achieving high social returns. The problem is that the departmentalised nature of national, regional and local government means that the savings are achieved across a broad front of the public sector, few parts of which see their role as being to support CDFIs or Credit Unions even where their housing estate, health costs, benefit claims or tax revenues would all be improved by so doing.

An example would be in micro lending for self employment where the result of the loan is that someone formerly on benefits has become self employed. Not only is there a saving to the public purse from benefits payments but there will also be positive tax revenues. One way to evaluate this is to assess mission-driven sustainability which, in the case of CDFIs and Credit Unions, is the extent to which the third-sector lender is able to reach and work with the most financially-excluded clients.

The main measurement tool used in relation to these organisations is average loan size as a percentage of GVA per head in the region. The rationale behind this internationally accepted metric is that poorer clients require smaller loan sizes, so it operates as a proxy for depth of market penetration to reach and work with the most financially excluded. Using GVA allows us to standardise the measure relative to regional wealth.

Organisation	Av. Loan Size/ GVA per head
Triodos	2241.34%
Bridges	1869.98%
BIGInvest	1254.80%
Charity Bank	376.44%
SECLF	358.51%
C & CF	129.07%
Capitalise	40.33%
ELF	22.38%
Prime	22.18%
Fredericks	14.87%
Prince's	10.04%
Isle of Wight CU	5.38%
S'hampton CU	4.95%
SCML	4.90%
P'mouth CU	3.48%
Bedford CU	3.23%
Isle of Thanet CU	2.72%
Amicus	2.69%
Hastings & CU	2.57%

The graph overleaf excludes social enterprise lenders, as their loans are generally very large. However, their clients are assumed to act as intermediaries for socially and financially excluded people in deprived communities.



The table and graph above shows that the Credit Unions and South Coast Money Line work with the most financially excluded clients, with ratios of 5% and below. By international standards, this is a significant achievement in terms of reaching extremely financially excluded people. The enterprise lenders also achieve significant levels of market penetration ranging from 10% for Prince's Trust up to 40% for Capitalise. Internationally, ratios below 100% are regarded as successful in terms of depth of market penetration.

Defining, measuring and evaluating outputs, outcomes and impact is a weakness among some third-sector lending organisations, many of whom are still relatively young. It was intended to assess the percentage of clients based in the most deprived Super Output Areas in the Region, as an addition to the analysis above. However, too few of the organisations were in a position to provide information about the location of their clients. Yet evaluation need not place too much of a burden on organisations, if they build it in to their systems. The examples below show the type of client tracking carried on by some of the organisations involved, which can help to make the case for support to funders:

ELF: 94% start-ups, 6% BME, 6% lone parent, 6% over 50

Bridges: 30% in most deprived 5% of wards, 64% in most deprived 10%

Fredericks: 39% unemployed, 16% with disability, 5% single parents, 5% ex-offenders

Portsmouth Savers: 64% women, 26% over 50

Funders obviously need to balance scale and impact of operation with mission-driven sustainability, but the third sector lenders shown above can make the case that they are successfully reaching and working with their target market of financially excluded people and entrepreneurs. However, CDFI's and Credit Unions are not able to make claims for the social returns accruing from investments in CDFI's and Credit Unions because no solidly-based analytical model for measuring social return has yet been produced. This would be a ground-breaking piece of research that would enable investment in CDFI's and Credit Unions to be carried out on the basis of evidence rather than hypothesis. A very practical application of the framework would be a pilot research project between a CDFI or Credit Union and a Housing Association to investigate how the expansion of financial services to social housing tenants

impacts on housing association costs and delivers social benefits. Given the National Housing Federation's commitment to financial inclusion, they might be willing to facilitate such a research partnership.

STRUCTURAL SUSTAINABILITY

An organisation can have operational and mission driven sustainability of below 100% and yet be sustainable if it can work out an alternative way of generating income or other forms of support to support its operating costs. This approach can be termed structural sustainability.

Third sector lenders use a variety of different business models to deliver financial services. Larger organisations and particularly social enterprise lenders making larger loans can afford to carry the overhead of a dedicated back-office operation and of general administration. This cost burden is far harder for smaller organisations to carry, particularly as smaller loans usually indicate more financially excluded clients who require more support to get through their loan. Some organisations have developed different models of operation to improve their structural sustainability, as the examples below illustrate:

Prince's Trust is a national organisation which was founded in 1976 by the Prince of Wales. It started with 21 pilot projects around the country. Its business start-up programme was launched in 1983. The operational sustainability of the business start-up programme has always been low. This is the result of intensive staffing, low average loan sizes and significant write-offs. But the Prince's Trust achieves financial sustainability through its structural ability to raise astonishing amounts through fundraising. They launched a £40 million appeal in the Prince's 40th birthday year, which was matched by the government to produce a total of £80 million. It runs a huge range of fundraising activities including Fashion Rocks, the Urban Music Event and this year, a national fundraising and advertising campaign. It has a UK-wide national strategy, but each of English regions has its own Director and Council, as do Scotland, Wales and Northern Ireland. In the South-East, the Prince's Trust has a regional office in Farnham and local offices covering Berkshire, Buckinghamshire/Milton Keynes/Oxfordshire, Hampshire and the Isle of Wight, Kent, Surrey and Sussex.

Fredericks Foundation received start-up advice from the Prince's Trust but is now developing its own innovative approach to structural sustainability. It is a charity with a subsidiary company limited by guarantee, Fredericks Services Ltd. This company provides IT services to other charities, with two self-employed staff providing sales and technical support. It has reached favourable deals with a number of major IT suppliers which enables it to supply other charities at reasonable cost while still making profit to reinvest in the charity itself. In addition, the Friends of Freds initiative has recruited 15 companies to date which donate 1% of their net profits per annum. Fredericks' fundraising initiatives include the Hannibal Challenge, a two-day walk over the Alps to raise money through sponsorship. Overall, the Foundation's aim is to raise 50% of its funding through commercial and charitable sources.

Capitalise Business Support is a subsidiary organisation of 1066 Enterprise in Hastings and St Leonard. This gives the organisation access to resources and the capacity to share administration and support services. It also benefits by being part of the wider network of Enterprise Agencies, both in terms of referrals of clients to Capitalise and the capacity to refer Capitalise clients for business advice and support. Unlike some other organisations, however, by running Capitalise as a separate company, its financial and operational performance is transparent to management, its parent organisation and wider stakeholders such as its funders. This option combines the benefits of increased sustainability and transparency.

7. SUSTAINABILITY MODELS

The terms of reference for the study included the requirement to assess the actual and potential sustainability of CDFI's and Credit Unions in the Region. This chapter uses the concept of portfolio yield (the rate of return achieved by the financial providers on the balance of outstanding loans) to develop standardised sustainability models for the sector.

SOCIAL ENTERPRISE MODEL

The table below shows a model of social enterprise lending that can comfortably reach sustainability. The model shows that a lender with just over 40 loans outstanding with an average loan balance of £50,000 can be run with one full-time lender and one part-time administrator. It can cover its employment and operating costs and loan losses at 2% of the portfolio outstanding and produce a small operating surplus.

Most social enterprise lenders are operating at national scale, even when like LIF they run regional funds, and can expect to surpass this level of lending. Social enterprise lenders may need seed-corn support to get off the ground or to expand their operations into new regions, but the model is sustainable.

The only proviso relates to the need for business advice and training services for their clients, many of whom may require this support in order to reach investment-readiness. However, social enterprise business support is outside the remit of this study.

SOCIAL ENTERPRISE MODEL	£
Portfolio Outstanding	2,100,000
Av loan balance	50,000
No of loans	40.2
No of staff	1.5
No loans/staff	27
Loan losses	2%
Gross Portfolio Yield	7%
Interest income	147,000
Operating Expenses	
Salaries and benefits	75,000
Admin expenses, rent etc	25,000
Loan losses	42,000
Total Op Expenses	142,000
Operating Surplus/Deficit	5,000
Sustainability	103.52%

SMALL BUSINESS MODEL

A regional lending operation providing large micro or very small business loans (£7,500 - £20,000), whether run by one of the existing Enterprise CDFI's or as a partnership between them, can also reach sustainability. The SEEDA Financial Inclusion Baseline and Mapping Study (Small Change Partnership) estimated that there was the potential to make 292 loans in this market segment across the South-East every year. The sustainability model below is based on 165 loans outstanding, which given an average loan term of 4 years, would only require only just over 30 loans per year to reach sustainability. Providing this service through existing organisation, utilising their staff and resources would enhance the sustainability of those organisations.

The table below shows that with two full-time staff each handling just over 82 live clients and an average loan balance of £12,500, a Portfolio Outstanding of £2,062,500 would generate a net yield of £247,500. This would be sufficient to cover employment costs, operating costs, a loan loss rate of 5% and deliver an operating surplus of £34,375.

MICRO/SMALL BUSINESS LENDING	
Portfolio Outstanding	2,062,500
Av loan balance	12,500
No of loans	165
No of staff	2
No loans/staff	82.5
Loan losses	5%
Gross Portfolio Yield	12%
Interest income	247,500
Operating Expenses	
Salaries and benefits	60,000
Admin expenses, rent etc	50,000
Loan losses	
Total Op Expenses	213,125
Operating Surplus/Deficit	34,375
Sustainability	116.13%

MICROFINANCE MODEL

It has not been possible to produce a standalone microfinance model that will reach sustainability. The model is constrained by:

- The number of clients that a loan officer can handle, given the extra support need in the application process and in terms of follow-on support to complete the loan;
- Acceptable interest rates. Doorstep lending rates averaging 177% cannot be justified, as has been confirmed in the initial findings of the Competition Commission inquiry on the supply of home credit. Current microfinance rates average 14% and write-off rates average 8%, giving a portfolio yield of 6%. Assuming that loan losses remain steady, two loan officers are employed and they handle a maximum of 100 clients each, the CDFI would need to generate a net portfolio yield of 25% and therefore charge 33% on its loans to break even

The table below is based in consultations with existing microfinance providers in the South-East and with East Lancs. Moneyline, the leading combined personal and microfinance lender in the UK. It assumes that one senior/managing loan officer, two junior loan officers and one administrator are employed. The average interest rate is 16% and the average loan size is £3,000. The highest level of sustainability that the organisation can reach is 60%.

This conclusion is supported by the recent report funded by the Esmee Fairbairn Foundation, CDFA and others on Aspire – Micro Loans for Business[5] which predicted that top performers in the UK could not be expected to achiever higher than 60-80% operational sustainability. "CDFI's following this model are always likely to need to find other ways of supporting operations – through grants, other income-generating activities or income from endowments and other assets."

[5] Forster S, Lederman L, Mayshak J, Mercer T, Aspire – Micro Loans for Business: Operational and Funding Lessons for the Future of Microfinance in the UK, CDFA and Esmee Fairbairn Foundation

MICROFINANCE SUSTAINABILITY	
Portfolio Outstanding	900,000
Av loan balance	3,000
No of loans	300
No of staff (3 LO, 1 Admin)	4
No loans/staff	75
Loan losses	8%
Gross Portfolio Yield	16%
Interest income	144,000
Operating Expenses	
Salaries and benefits	120,000
Admin expenses, rent etc	50,000
Loan losses	72,000
Total Op Expenses	242,000
Operating Surplus/Deficit	(98,000)
Sustainability	60%

PERSONAL LENDING MODEL

The personal lending model below can be applied to Credit Unions or CDFI's as it ignores the cost of capital, which has been the difference between the two organisations. Credit Unions traditionally captured members' savings on which they paid a dividend and onlent them. CDFI's either received capital grants for onlending or borrowed funds through Community Investment Tax Relief. Although the governance and control differences between the two types of organisations remain, the way in which larger and more successful Credit Unions operate is now closer to the CDFI model, as they receive revenue and capital grants and use CITR wholesalers to access funds. However, Credit Unions can use member savings to offset against their loan losses, so two version of the model have been produced to reflect that difference.

The Credit Union model shows that with 5 staff and 2,500 loans outstanding averaging £800, the CU can achieve a comfortable level of sustainability with a portfolio yield of 14%.

CREDIT UNION SUSTAINABILITY	
Portfolio Outstanding	2,000,000
Av loan balance	800
No of loans	2,500
No of staff	5
No loans/staff	500
Loan losses	4%
Gross Portfolio Yield	14%
Interest income	280,000
Operating Expenses	
Salaries and benefits	100,000
Admin expenses, rent etc	70,000
Loan losses	80,000
Total Op Expenses	250,000
Operating Surplus/Deficit	30,000
Sustainability	112%

The CDFI Model reflects its higher write-off rate in its higher gross yield of 18% (delivering the same net portfolio yield of 10% as the Credit Union model). However, as credit unions move away from insisting on savings first before issuing loans to new members and offer more differentiated credit products to a wider range of members, it is likely that they will increase interest rates, at least to higher risk customers. The only alternative to this is to commit to permanent subsidy of interest rates through grant aid.

It should be stressed that this is a very challenging model requiring those credit unions and CDFI's with the capacity and the will to expand to grow substantially until they are serving roughly 5,000 members or 2,500 loan clients at any one time. This sustainability option is not open to smaller credit unions, those in rural areas and those without the support of outside stakeholders to help them grow and develop.

CDFI PERSONAL LENDING SUSTAINABILITY	
Portfolio Outstanding	2,000,000
Av loan balance	800
No of loans	2,500
No of staff	5
No loans/staff	500
Loan losses	8%
Gross Portfolio Yield	18%
Interest income	360,000
Operating Expenses	
Salaries and benefits	100,000
Admin expenses, rent etc	70,000
Loan losses	160,000
Total Op Expenses	330,000
Operating Surplus/Deficit	30,000
Sustainability	109%

MICROFINANCE

There is a sustainability gap in the provision of enterprise finance to start-up and existing micro-enterprises. This gap will remain even if current providers scale up and come much closer to meeting the coverage gaps in the Region. There are three main options open to providers:

- CDFI's can raise their average loan sizes and terms by expanding upwards into large micro-enterprise and very small business lending. In order to achieve regional coverage and equality of access for entrepreneurs, this would best be achieved through co-operation;
- CDFI's can spread their fixed costs across a broader base by developing other services, as South Coast Money Line is doing with its home improvement loans, by bidding for business support contracts or by diversifying into other areas of work as the Fredericks Foundation is doing;
- CDFI's can operate as part of larger business support agencies as Capitalise and Enterprise Loan Fund do, with a subsidiary structure to support transparency of financial and performance reporting .

Over the next five years, CDFI's should aim to achieve 60% operational sustainability on the basis of their lending operations. This will ensure that they remain focused on meeting client needs and satisfying unmet demand. In the longer term, ongoing subsidy of operating costs will only be possible if CDFI's can convince their stakeholders of their mission-driven sustainability – that they are reaching the parts of financial exclusion that no other provider can meet and that their social impact is transparent and valuable.

PERSONAL LENDING

Credit Unions and personal lending CDFI's can achieve sustainability but only by focusing on substantial growth. Portsmouth Savers has demonstrated that this level of growth can be achieved in more populated areas. Beacon Credit Unions or CDFI's could be encouraged to develop to serve 5,000+ members in the following areas:

- Portsmouth, Southampton and Hampshire (Urban Hampshire Diamond for Growth)
- West Sussex including Horsham and Crawley (The Gatwick Diamond)
- Brighton, Hove and East Sussex (Brighton and Hove Diamond for Growth)
- Kent, including Thanet, Medway, Canterbury and Maidstone (Medway Diamond for Growth)
- Surrey including Guildford and Woking (London Fringe)
- Slough and Berkshire (Western Corridor)
- Milton Keynes and Oxford (Milton Keynes Diamond for Growth)

An innovative franchising model could be developed in the South-East to help serve the financially excluded in smaller, less densely populated or more rural areas. This could involve Credit Union volunteers carrying out local outreach and working as Directors and Credit Committee members for a local credit union with all of the back-office, support and marketing operations being carried out by one of the Beacon Credit Unions at a reasonable cost. With

good IT support, this solution could combine the benefits of local, on-the-ground knowledge and commitment with the experience and expertise of professional credit union staff.

The larger Beacon Credit Unions can be sustainable with 5,000 members. Based on past experience, small and ambitious credit unions in the right areas can grow to sustainability within five years with both revenue and capital support. Wherever possible, existing credit unions should be encouraged to grow and develop, rather than supporting the establishment of new organisations. The smaller and rural credit unions can stay working on an entirely voluntary basis with very limited impact or enter an arrangement with a larger credit union, as outlined above, increase their impact substantially but probably require ongoing support. This support can be justified on the basis of its financial inclusion impact.

9. SUMMARY AND CONCLUSIONS

TERMS OF REFERENCE

The Terms of Reference of the study were to focus on:

- The availability of financial services in the region;
- Assessment of gaps in provision; and
- Sustainability of CDFI's.

PERSONAL FINANCIAL SERVICES

Financial exclusion is a problem for a small but significant minority of residents in the South-East of England, affecting roughly 616,000 people mainly in the 20% most deprived Super Output Areas in the Region. Our surveys identified twenty credit unions working in the Region, of whom responses were received from fourteen. The other main personal finance provider in the South-East is South Coast Money Line, which is a CDFI. The top six financial inclusion providers made over 2,000 of the estimated 2,500 affordable personal loans in the Region. This means that 12% of the potential demand is being served. Areas which suffer from substantial levels of financial exclusion but have no service include Slough, Dover, Shepway, Gravesham, Swale, Arun, Maidstone, Ashford and Adur. In addition, there are areas where credit union coverage is available but take-up is low.

In order to develop a structure capable of meeting the needs of the financially excluded sustainably and over the long term, large and efficient Beacon Credit Unions need to be supported and developed in the following areas:

1. Portsmouth, Southampton and Hampshire
2. West Sussex including Horsham and Crawley
3. Brighton, Hove and East Sussex
4. Kent, including Thanet, Medway, Canterbury and Maidstone
5. Surrey including Guildford and Woking
6. Slough and Berkshire
7. Milton Keynes and Oxford.

These larger credit unions, serving 5,000+ members each should have the capacity to continue the development and roll-out of innovative products such as current accounts, cashcards, Cash ISAs and eventually pensions and insurance products.

Smaller, less populated and more rural areas could be supported by these Beacon Credit Unions by carrying out back-office, support and administration services, at a reasonable cost, for local Credit Union volunteers working on the ground.

MICROFINANCE

Stand-alone microfinance is not sustainable in the UK, but all of the existing providers in the Region have either developed or are developing alternative strategies for sustainability. The big challenge for these organisations is to scale up to begin to meet the untapped demand for enterprise support, particularly in deprived communities.

Financially excluded areas which have no enterprise coverage for over 30's include Slough, Dover, Milton Keynes and Oxford. The areas with the greatest potential for enterprise development include Brighton and Hove, Wycombe, Milton Keynes, Aylesbury Vale, Windsor and Maidenhead, West Berkshire, Wealden, South Oxfordshire, Elmbridge, New Forest, Waverly, Wokingham, Medway and Guildford.

CDFI's should be encouraged to bid to provide microfinance services in these areas on the basis of service-level agreements, with contracts terminated for non-performance. They should also be required to produce regional offerings of products and services particularly targeted at the specialist sectors where SEEDA has been keen to overcome economic inactivity. These include services for women, ethnic minorities, recent migrants and people with disabilities, with opportunities for different organisations to take the lead for different target groups. Finally, CDFI's should be supported to offer a regional product targeted at large micro-businesses with an average loan size expected of £20,000. This will fill a gap in the market and increase CDFI sustainability.

In order to achieve this co-ordinated approach to tackling enterprise financial exclusion in the South East, CDFI's should form a single, incorporated organisation that can act as a single point of contact for SEEDA and other regional organisations, can encourage co-ordination of activities and provide a conduit for finance for CDFI's in the Region. The single point of contact could also develop a single, regional interface for referrals and marketing information to link with Business Link and Finance South East and establish a web portal so that anyone in the region can identify their local provider of enterprise financial services. It is possible that CDFI's might decide to develop shared back-office operations at a future date, to reduce costs.

SOCIAL ENTERPRISES

It is clear that there is neither a shortage of social enterprise finance providers nor of capital for lending. The particularly low number of loans in the South-East (estimated at 21) seems due to a combination of reasons. These include the perception among the sector that the Region is relatively prosperous and therefore not a priority area. Also, social enterprises in the South-East are significantly less likely to be involved in real estate or property rental, sectors which often drive borrowing. They also have fewer full-time employees and are therefore likely to have less management resource to develop new enterprises or projects that require funding.

There does not appear to be any gap in market for social finance in the South-East that cannot be filled by current providers.

All five of the large social enterprise lenders, BIGInvest, Charity Bank, ICOF, LIF and Triodos, are accredited by the Small Business Service to use Community Investment Tax Relief and can wholesale funds for onlending to other CDFI's. Both Charity Bank, on behalf of the Esmee Fairbairn Foundation, and Co-operative and Community Finance have provided wholesale funds to Portsmouth Savers Credit Union to increase their available loan capital. Wholesaling money in this way brings a private sector discipline to CDFI's and forces the development and transparency of financial and social reporting systems. While smaller CDFI's may require some capital grants in particular where they are extending their operations into new areas or products, it is important that neither grants nor soft loans damage this developing capital market for CDFI's.

CONCLUSION

This study of the supply of Community Development and Credit Union finance in the South East of England has researched and reviewed the policy framework, the geographical coverage, the scale of operation and the sustainability of the organisations involved.

Some Credit Unions and CDFI's in the South-East have demonstrated the potential to tackle the problems of personal and enterprise financial exclusion in the Region. However, this study has provided an opportunity to review and clarify the scale of the challenge facing them if they are serious about addressing financial exclusion. They need to raise their game substantially if they are to be treated as a serious option in the provision of affordable financial inclusion services.

SEEDA may recognise that CDFI's and Credit Unions work in very difficult circumstances, spanning the boundaries between community development and financial services and reaching communities that other approaches cannot touch. They are innovative and challenging organisations and play a significant role in investing sustainably in local communities. They have advantages over project-funded solutions because of their longevity, their ability to leverage and combine capital from the private sector and the third sector. Most of all, efficient and effective CDFI's and Credit Unions that have grown to scale offer long term sustainability because of the capacity to recycle investment.

Financial inclusion services, covering personal finance, microfinance and social enterprise finance, can make a significant contribution to the economic and social development of the Region, as a central element in SEEDA's economic inclusion work.