the voice for social enterprise

8th February 2013

Baroness Kramer
Lead Member
Panel on Retail Competition
Parliamentary Commission on Banking Standards

RE: Submission to Parliamentary Commission on Banking Standards call for evidence to support alternative providers

Dear Baroness Kramer,

Social Enterprise UK welcomes this opportunity to respond to your work to create a more competitive and diverse retail banking sector. We are especially pleased to see this Commission recognise the important role that alternative providers can play in bringing greater diversity to the marketplace and the recognition that support is needed from government to enable these providers to continue to operate sustainably and grow to meet the demand for alternative finance.

Social Enterprise UK has always championed greater access to finance for our members and other organisations, including SMEs, charities and voluntary organisations many of which experience financial barriers. We know from our own extensive research[1] that poor access to available finance and/or the lack of affordable finance remains the largest barrier at start up and for sustainability for social enterprises. Only 17% of social enterprises approach their high street banks for finance illustrating the need for alternative finance providers. This is often caused or compounded by a lack of understanding among mainstream finance providers of what a social enterprise is.

To help address these challenges Social Enterprise UK leads the Social Investment Forum – a collective of social investment and finance intermediaries – working together to influence policy and provide practical support to help social enterprises access appropriate and affordable finance.

As this call for evidence is centred on looking at ways to diversify retail finance provision, our submission is focused on supporting the needs of community finance providers, in particular, Community Development Finance Institutions (CDFIs), as well as peer-to-peer lenders and crowd funding organisations. We support the responses submitted separately by the Community Development Finance Association (CDFA) and BuzzBnk.

The focus of this submission is: highlighting the role and advantages of alternative forms of provision specifically for social enterprises; identifying key barriers for growth and effective service; and presenting opportunities and policy recommendations to better support alternative finance providers.

[1] *Fightback Britain: A report on the State of Social Enterprise survey 2011*, Social Enterprise UK

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1) **The advantages of alternative forms of provision for consumers as well as the contribution you make to the wider economy**

Community finance:

Community finance can create economic opportunities, while helping to regenerate and stabilise neighbourhoods and alleviate poverty.

As major providers of community finance in the UK, CDFIs provide finance products and services to communities traditionally underserved by mainstream commercial financial institutions. By providing access to finance to those unable to secure it from mainstream sources, CDFIs not only deliver capital to disadvantaged communities, they recycle capital within those communities by returning their borrowers' repayments back to the community in the form of new loans.

There are currently around 60 CDFIs providing finance and support in the UK today. Despite consolidation in the numbers of CDFIs they continue to grow their portfolios and lending operations.

We believe that community finance should be a core element of the Government's ambition to create alternative markets and unlock new pools of capital, providing consumers and small business with greater choice and diversity of finance provision.

Recent developments in government policy such as the focus on localism, the opening up of public services to a wider range of providers and the move to a regime of payment by results in the delivery of public services, have significantly increased demand for community finance as a major player in alternative finance provision. In turn, this increased demand has highlighted the need to support CDFIs and other intermediaries to meet this demand.

Investment into growing the community finance market has the potential to generate sustainable economic development and build more resilient communities. Community finance providers, such as CDFIs, have already demonstrated their ability to deliver economic and social outcomes across Government policy, including:

- Serving over 14,000 businesses, 3,500 charities and social enterprises and 95,000 individuals and homeowners, since 2004; and
- providing 33,000 loans totalling £200 million in 2011/12, which:
    - financed 2,600 businesses and 350 social ventures creating and protecting over 8,300 jobs
    - saved 29,000 people from high cost lenders, avoiding £7.5 million in interest payments
    - funded essential improvement to 1,140 substandard homes

CDFIs complement rather than compete with mainstream banks; filling a significant gap where the market fails to provide a solution. The profit-driven nature of the banking industry has unintentionally resulted in 'underserved markets' where individuals and businesses are unable to access affordable credit.

CDFIs help bridge the gaps in the market by providing finance to underserved businesses, civil society organisations and households. An independent review of CDFIs published in March 2010 found that "CDFIs continue to address consistent market failure to reflect the economic and social benefits of lending in underserved markets" [*Evaluation of Community Development Finance Institutions (CDFIs)*, GHK, BIS and Cabinet Office, March 2010]

Further CDFIs play an important role in developing a pipeline for banks to invest in. Their investments build financial capability, helping organisations to grow and build stronger financial track records. Once their customers have achieved some success, established a good credit history and have become substantial, they can “graduate on” to borrowing larger amounts from banks.

There are some commercial alternatives particularly when it comes to lending to individuals. These are often called ‘payday’ and ‘doorstep’ lenders and pray on those unable to participate in the mainstream financial arena.

CDFIs lead the way in investing in disadvantaged communities and bringing people into the economic mainstream as contributors to the economy. They cultivate specialised knowledge about the communities in which they operate and forge relationships with customers and the community, often providing credit counselling to consumers and business support to enterprises and social ventures, helping them utilise their financing effectively. These support services are too resource-intensive to be provided by commercial driven entities.

CDFIs can support growth by reaching markets commercial institutions cannot, they stimulating enterprise and growth in communities that would otherwise simply not have access to financial services. CDFIs are instrumental in delivering current government programmes such as the DWP’s New Enterprise Allowance Scheme and BIS’s Regional Growth Fund, and will soon initiate delivery of BIS’s StartUp Loans Scheme.

Crowd funding:

Crowd funding is another effective method of providing alternative finance, with many advantages for consumers and the wider economy.

Buzzbnk is an on-line crowd funding platform bringing social ventures looking for start-up or growth capital together with like-minded people keen to participate in a new way of funding social change. Social enterprises or charities can raise funding for a wide range of projects in a variety of ways, from offering fun and engaging benefits, in return for goods or services, or as a loan.

Buzzbnk is a social enterprise owned over 50% by leading charities and foundations in the UK and has a social purpose mandate to support the social enterprise, social investment and charitable sector.

Through its online platform crowd funding is able to build strong long term relationships, based on co-venturing and reciprocity, between investors and investees to strengthen businesses. Often the “crowd” provides more than just financial investment – they may contribute in-kind support, such as business and marketing expertise, to support the business(es) they are investing in.

By not being dependent on one or two key finance sources, the business is able to access a much larger diversified pool of support in times of difficulty, including provision of further sources of finance.

The experience of crowd funding platforms such as BuzzBnk is that a proportion of the early supporters go on to lend and invest in the same businesses again and for larger amounts; this builds a sustainable and expanding pool of capital and support base. This also helps to reduce the risk the venture will face in accessing finance in the future.

An important advantage of alternative finance providers such as BuzzBnk is their reach and ability to cater for businesses and groups which experience financial exclusion. BuzzBnk, along with other socially motivated peer-lending platforms (e.g. KIVA) expect that a proportion of returned funds (e.g. from a revenue share, interest or principal repayment) to be re-lent again.

2) **Whether there are regulatory or other barriers which are acting as a constraint on your ability to grow and serve your customers effectively**

Community Finance:

The absence of any meaningful legislation or regulation to ensure that all communities across the UK – whether defined geographically or socio-demographically – have access to finance is a primary obstacle in providing community based alternatives to the mainstream/commercial financial services industries.

The current regulatory approach within the financial services sector does not recognise of take into account finance as a public good. In the UK, no such policy framework exists to incentivise the commercial finance sector to serve the underserved, neither does a framework exist to support alternative community finance, and therefore provision of such is grossly inadequate. Recent research[2] identifies unmet demand for alternative community finance at ca £6 billion per annum, of which alternative finance providers are able to meet only £0.7b, that is, 12% of demand. The commercial financial sector, by definition, is unable or unwilling to serve these customers and meet this unmet demand.

Those unable to access affordable credit provided responsibly must either rely on friends or family for finance, use high cost credit or credit cards, fall prey to loansharks, resort to criminality, or 'do without'. Neither the commercial banking sector – due to its motivations – nor the alternative community finance industry – due to underdevelopment - is in a position to meet this need.

The private sector cannot and will not provide access to credit to markets deemed risky -- unless profit is to be gained by such activity. Unless conducted as a marginal CSR-style activity, no commercial financial providers are in a position to provide access to finance to the likes of start-up entrepreneurs, businesses in deprived areas, community groups, not-for-private profit social enterprises, those on low incomes and without collateral, and so forth.

The US has legislation in place designed to encourage commercial banks to help meet the needs of borrowers in all segments of their communities, including low- and moderate-income neighbourhoods, consistent with safe and sound operation. This holistic integration of a unified financial services system has led to the development of a robust and widespread alternative community finance sector which operates in partnership with the commercial banking sector. The UK has no such equivalent.

There are low and inadequate levels of investment from government and other institutional investors in the community finance market meaning that community finance providers are unable to meet their demand from businesses, social enterprises, charities and individuals.

The key piece of legislation in place to support CDFIs, Community Investment Tax Relief (CITR), has been unable to address this. The majority of the amount raised has been by deposit-taking CDFI banks able to attract investment using a simple savings deposit product guaranteed by the Financial Services Compensation Scheme. 'Typical' non-bank CDFIs find it difficult to attract investors due to a variety of challenges inherent in the current version of the scheme. When originally devised, it was envisioned that CITR would drive hundreds of millions of pounds' of private investment to the CDFI sector, mostly in the form of investments by banks and other large corporations. However, investment in the form of loans from banks comprised only 17% of the total raised since 2003, and investments by corporations and individuals have accounted for only 1%. CDFI banks able to take investment as savings deposits backed by a guarantee has accounted for the overwhelming majority of the amount raised to date, over 80% of the total.

The 2011 budget announced not only would CITR be retained when it came up for renewal in 2012, but George Osborne "encouraged people to take it up." In preparation for a renewed scheme, HMT undertook a consultation with the CDFA and CDFIs in late 2011. Two reforms were announced in the 2012 budget: a relaxation of on-lending requirements and allowing investors to carry unused relief forward. However, it is widely felt that these reforms fell short of what is needed to fulfil the potential originally envisaged for CITR.

[2] *Mind the Finance Gap*, ICF GHK, 2013

For meaningful growth to continue, CDFIs, policymakers and funders must recognise the need to focus on those markets that are hardest and most expensive to reach as the essence of community finance, accepting that delivery of high impact outcomes can only be achieved through measures which cannot be established without commitment or without cost. Expanding existing and launching new CDFIs where none exist, providing finance to microenterprises, social ventures and financially excluded households, delivering service in rural areas and the other activities that CDFIs undertake are essential components in meaningful delivery of fair and affordable community finance.

Crowd funding:

Currently, there is an inadequate level of regulation which addresses all forms of repayable (e.g. loans) and equity finance facilitated by an internet platform. The absence of regulation which supports and clarifies the role of such platforms, offering a variety of financial instruments, fosters a lack of trust in alternative finance provisions such as crowd funding platforms. This uncertainty also affects alternative providers' ability to raise its own investment to grow their service and reach.

Many crowd funding and peer-to-peer lending platforms, such as BuzzBnk, would recommend that a specific authorisation regime should be introduced by the Financial Conduct Authority to facilitate online direct investment facilities. Such regulation should be proportionate - driven by a balance of the need to protect and educate the consumer *while* reducing the cost of raising finance and increasing the availability and pool of finance for social and community enterprises.
For example, Buzzbnk has helped organisations raise investment from as little as £1,000 in loans, with the largest being close to £200,000 for an organisation. However, these are relatively small amounts compared to the amounts raised via the traditional finance markets – which may spend at least £150,000 or more to meet Financial Promotions requirements to raise a large corporate bond of £20 million. Proportionality of the amount of funding being raised by the organisation to the amount of due diligence required is therefore, paramount. The cost of "preparing the public offering" needs to be proportionate and not excessive to the amount of risk.

The US legislation 'Jump-Start Our Business Startup Act (JOBS)' has helped to address similar issues experienced in the US. Similar measures should be considered for the UK, specifically looking at reducing operational risk of platforms and consumer risk. In particular, it would be valuable to explore the concept of a consumer protection cap which allows ordinary retail investors to invest up to a certain amount in any company directly and/or in aggregate across all direct financing platforms per year.

3) Whether there are policies which government, or other related bodies should be pursuing to promote alternative forms of finance

This Government has already introduced a vast suite of initiatives designed to support access to finance more broadly. As a general recommendation, these initiatives – ranging from specific funds and programmes including, Funding for Lending, Business Growth Fund, and Start-Up Loans, to institutions such as the Green Investment Bank and, tax reliefs, including EIS/VCT – should all be reviewed and proofed to ensure that they also support new and innovative alternative models of finance and not just the established models prevalent in the mainstream finance market.

Community finance:

Intensifying the valuable role government already plays in recognising the work of CDFIs to ensure the resources and infrastructure are in place to realise the significant potential should be pursued.

- A bank-to-CDFI referral scheme, a partnership between CDFA and the British Bankers Association, is an important infrastructure development that offers declined bank customers a robust and viable alternative, and if successful will significantly increase demand for CDFI finance. To meet this and other needs associated with scaling the sector, we urge government to implement the following measures:

- Set up a CDFI fund to establish new CDFIs where there are none, and help existing CDFIs to expand. The government backed Phoenix Fund increased the number of CDFIs from 25 in 2000 to 73 in 2008. A sample of 39 CDFA member CDFIs that received £22m through the fund, grew their portfolios to £42m and loan fund capital holdings to £80m by 2009. This boost allowed for a leverage of £2.10 on the portfolio and £4 on the loan fund size for every £1 invested.

- Create a loan guarantee scheme designed specifically for the CDFI sector that would underwrite losses associated with these higher risk markets, thereby ensuring that more capital is available for lending. The current Enterprise Finance Guarantee (EFG) is not applicable to those providing credit where mainstream providers do not.

- Harmonise tax relief schemes, to incentivise private investment into the community finance sector. Whilst the current scheme – Community Investment Tax Relief (CITR) – has enabled CDFIs to raise around £86m, this is a small proportion of what was predicted due largely to the level of relief being lower than comparable schemes. We ask that this be revised, to match comparable schemes such as the Enterprise Investment Scheme.

- Given their ability to reach excluded markets, CDFIs should be viewed as a core delivery partner in the Business Bank to maximise the positive impact of this resource within those markets that other schemes, such as the Funding for Lending, have struggled to penetrate.

Crowd funding:

- Promote and encourage matched loan funds for direct financing platforms for the sector from large foundations and pubic funding bodies (e.g. big lottery fund, big society capital) of varying risk levels with the awareness and emphasis that there are large gaps for high-risk early stage capital.

4) Mechanisms to raise public awareness of the existence of alternative forms of finance and provision

There are many mechanisms which have already been established to raise public awareness of alternative forms of finance and provision, and they exist in various forms from online platforms and networks (such as the Social investment Forum) to campaigns and ongoing engagement work by support organisations and trade bodies. As such, there is already valuable expertise within the social enterprise and social investment and finance sector on what is needed to raise awareness and how this could best be achieved. To varying degrees much of this work is already underway but what is missing remains the capacity to do this at scale and at a level which reaches the most difficult to access communities – for example, often the information available just needs to be communicated differently or delivered/disseminated in more inclusive and convenient formats.

Mechanisms to raise public awareness should be designed and implemented with the following considerations:

- **Capacity building for existing mechanisms -** there are already established mechanisms developed by varying organisations and groups to raise public awareness – any new initiatives developed should utilise and work to strengthen the capacity of these organisations to build on their expertise and magnify their ongoing efforts and impact.
- **Targeted approach to reach the financially excluded -** the recipients of alternative forms of finance and provision are likely to have different needs to those which are able to access mainstream finance (they often require more holistic and patient support) – it is therefore, essential that alterative providers and support bodies working in this field are meaningfully

consulted in the development of initiatives to raise awareness which are relevant, appropriate and effective.

- **Resources for co-ordination and collaboration:** the myriad of alternative forms of finance and provision available – not to mention the ongoing innovation in this market – means that co-ordination and collaboration between varying organisations delivering a range of mechanism from advisory services to guides and events is paramount. Working in silos results in unnecessary duplication, disproportionate responses to need and conflicting information – all of which dilutes the potential to raise public awareness. However, this co-ordination is extremely resource and capacity intensive and requires specific attention and funding allocated to it.

We look forward to working with you and the Commission to support alternative providers. Please do get in contact should you require further clarity or have any questions about this response.

Yours sincerely,

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