findings

Community reinvestment in the UK

There is a stark and growing finance gap in disadvantaged neighbourhoods as public funding declines but private investment has not taken its place. Community finance initiatives have emerged to tackle this gap. They start from a simple idea: that people and groups excluded from or invisible to mainstream finance can still be bankable. Research from the New Economics Foundation has found:

- Disadvantaged neighbourhoods typically have least access to capital. Those facing acute finance gaps include individuals, micro and small businesses, small housing associations and the wider voluntary sector.
- Community finance initiatives are flexible, creative and persistent in promoting investment in disadvantaged neighbourhoods.
- Five distinct models of community finance now operate in the UK: credit unions; community loan funds; micro-finance funds; mutual guarantee societies; and social banks.
- These models serve directly or indirectly around half a million people and have assets of over £400 million. The number of community finance initiatives in the UK has risen fourfold over the last five years.
- Community finance initiatives use a variety of non-conventional ways of delivering financial services which reduce risks and operational costs, and avoid recourse to above market rates. They have in general a good record on default and financial sustainability. In contrast, many public sector-led funds offering 'soft' (subsidised) loans have performed poorly.
- The researchers conclude that there remains a mismatch between the scale of the problem, in terms of access to capital, and the current capacity of the solutions. Yet with adequate policy support, fee earning from investment activities and some subsidy, community finance initiatives could increase in scale and impact and become attractive partners to banks.

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NOVEMBER 1998

Community finance initiatives

If we are to increase the amount of capital for community and economic regeneration it is essential to tap the full resources of private markets, because the demand far exceeds what can be supplied by philanthropy or by the public sector.

Community finance initiatives widen the access of disadvantaged people and communities to capital. The diverse initiatives can be grouped into five models:

Credit unions are not-for-profit, co-operative institutions for saving and borrowing, where members with a common bond save in the form of shares which are then relent to members. Four hundred thousand people now benefit from the services of over 700 credit unions in the UK. While primarily geared to personal finance, which is outside the scope of this research, a few credit unions are beginning to provide loans for self-employment and micro-enterprise.

Community loan funds serve community regeneration initiatives by making capital available. Loans are often co-ordinated with or used to lever in other sources of capital as well as subsidy. UK community loan funds are often charitable but not exclusively so. There are now 11 community loan funds in the UK, with assets of over £74 million. These have helped lever in additional commercial investment, in ratios of up to 1:10.

Micro-finance funds make very small loans to micro-entrepreneurs, typically working as sole traders or in business with family and friends. Such initiatives charge borrowers close to market rates of interest and aim to keep costs low without relying on traditional collateral or equity requirements. The Prince's Youth Business Trust, helping unemployed young people, is the largest micro-finance organisation in the UK.

Mutual guarantee societies are formal associations of small and medium-sized enterprises which pool their savings in banks to offer collective guarantees so that they can borrow more and achieve better lending and deposit rates. Over the last four years, eight mutual guarantee societies have developed in the UK.

Social banks are for-profit financial service providers dedicated, typically in their constitution, to social or environmental objectives. In other industrialised countries, mainstream banks have also established social banking subsidiaries.

The origins of community finance date back to the 1960s and 1970s, when pioneers in the co-operative sector established the first credit union and the first community loan fund in the UK. Over the last five years, the number of community finance initiatives has risen fourfold. Together, they now serve, directly or indirectly, around half a million people and have assets of over £400 million.

Community finance initiatives serve a variety of needs (see Table 1). But together they serve a significant number of people who are relatively marginalised or excluded from society.

What contribution does community finance make to regeneration?

In economic terms, areas of high social exclusion are characterised by low savings, under-investment and low multipliers of local spending. Those in disadvantaged neighbourhoods that find it harder to get access to capital include individuals, micro and small business, small housing associations and the wider voluntary sector. The withdrawal of local banking services has contributed to such exclusion.

While finance alone is rarely an answer to complex patterns of social exclusion, community finance initiatives are able to address a wide range of

Table 1: **Diverse needs, diverse solutions**

Level	*Examples of need*	*Possible barriers to access to capital*	*Relevant community finance initiatives*
Small business finance	Development finance	No general shortage of funds, except for new ventures and micro-enterprises, but some can't find appropriate finance	Community loan funds, social banks, mutual guarantee schemes
Micro-enterprise for individuals and families	Start-up/working capital, business skills	Lack of collateral, labour intensive to assess, transaction costs	Micro-finance
Community, social or charitable enterprise	Project finance, working capital, facility finance	Unconventional structure and business, complex funding mix	Community loan funds, social banks

economic needs and opportunities. Micro-finance 'pump-primes' local micro-enterprise. Mutual guarantee societies sustain small enterprises. Community loan funds increase inward investment. By investing in local community and social enterprises, they also support essential services for disadvantaged communities.

Community finance as partnerships

Community finance initiatives work best when in partnership with the private and public sectors (see Figure 1).

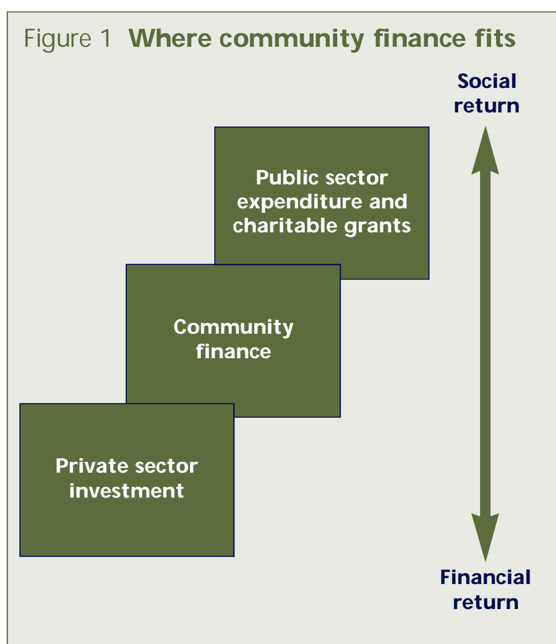
Community finance initiatives benefit from involvement or support from the private sector because they demand a high degree of financial and business competence and may require access to equity (or equivalent) or borrowed capital. Some banks have pro-actively supported community finance initiatives. Beyond goodwill or active social responsibility, leaders in the field are exploring the emerging business case for bank involvement:

> Successful community finance initiatives can bring transaction or information costs down to enable banks to do business in partnership, including serving markets on a wholesale rather than a retail basis.

> Community finance initiatives enable banks to learn about the sectors covered, identify emerging opportunities and recruit customers.

Indeed, a one per cent shift in all the activities of mainstream banks towards regeneration would represent more funds than are available from all existing community finance initiatives.

Figure 1 **Where community finance fits**



Government organisations also have a critical role to play in community finance, but usually not as direct lenders. Public sector funds offering 'soft' (subsidised) loans, for example, have not typically been effective development vehicles.

The advantage of loans over scarce public sector grant finance is that funds are reusable whereas grant finance is spent only once. Community finance therefore offers opportunities for furthering public policy at lower cost on a wide range of issues, including sustainable development, childcare, training, employment/self-employment, housing and health.

Experience overseas

Micro-finance reaches more than 13 million people in developing countries. European initiatives have financed up to 3,000 social economy projects a year and have invested $1 billion. Mutual guarantee societies in continental Europe are well-developed. In the USA, 310 community finance initiatives have emerged. These have financed over $3.5 billion of community economic ventures and now manage £1.8 billion of funds. Under the Community Reinvestment Act, US retail banks have also committed around $300 billion to low- and moderate-income neighbourhoods and have discovered that such lending is profitable.

What do we learn from community finance?

In the UK and overseas, community finance initiatives have tested models that have successfully:

- Served individuals and groups that are not conventionally seen to be bankable and improved access to capital, without recourse to above-market rates.
- Proved that the clients they serve are able to use financial services effectively to reduce vulnerability and increase incomes.
- Demonstrated that there are non-conventional ways of delivering financial services which reduce risks and operational costs.

Financial sustainability

The sustainability of community finance is improving, particularly among more established social banks, community loan funds and larger credit unions. As social enterprises, these initiatives have found creative ways to achieve or approach sustainability. Loss rates are competitive for successful initiatives. For UK credit unions, for example, written-off bad debts represent an average of 2.9 per cent of total assets. A third of community loan funds are running bad debts of less than 3 per cent, and social banks of less than 1 per cent.

Community finance in perspective

However, there remains a substantial gap between the scale of the problem and the current capacity of the solutions. Only five areas, for example, have dedicated local community loan funds. The majority of loan funds and mutual guarantee societies have been established during the 1990s. Most micro-finance funds are still under development. Recent growth among credit unions reflects the emergence of workplace credit unions; few community credit unions in low- to moderate-income areas have more than 500 members.

Nevertheless, the success of initiatives here, and of experience overseas, points to useful models which could over time bridge this gap.

Conclusion

The researchers conclude that there is considerable scope for the development of community finance in the UK. However, a pro-active policy and development framework is necessary if existing initiatives are to scale up with an enlarged capital base and new ones are to emerge. The following policies would assist this:

Improving access of community finance initiatives and their clients to technical assistance, by establishing equal opportunity obligations for enterprise support agencies and developing a network of diverse technical assistance providers who serve local economies.

Enabling community finance initiatives to support regeneration through a Community Capital Fund of up to £40 million, micro-finance initiatives and appropriate regulation.

Enhancing the prospects for viable credit in disadvantaged neighbourhoods through targeted loan guarantees and new reinvestment partnerships engaging banks, community finance initiatives and the public sector.

Developing incentives for financing community finance initiatives through tax credits.

Creating market conditions favourable to social responsibility by requiring banks and other mainstream financial service providers to disclose publicly their record in serving poorer communities.

About the study

The research aimed to provide the first assessment of community finance initiatives in the UK, in relation to three sectors relevant to regeneration: micro- and small business, housing associations and the wider voluntary sector. An assessment of relevant finance gaps was completed through desk research. In-depth interviews were carried out with staff from community finance initiatives and their users. Two panels involving representatives of banks, building societies and business support agencies were held to explore the interaction of community finance with mainstream service providers. A series of field trips to the USA and continental Europe, involving more than 50 interviews, were completed both to provide a benchmark for the UK experience and explore international experience of policy and practice relevant to the context of the UK.

How to get further information

The full report, Small is Bankable: Community reinvestment in the UK by Ed Mayo, Thomas Fisher, Pat Conaty, John Doling and Andy Mullineux, is published by the Joseph Rowntree Foundation (ISBN 1 85935 047 X, price £11.95 plus £1.50 p&p).

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Published by the
Joseph Rowntree Foundation
The Homestead, 40 Water End, York YO30 6WP
Tel: 01904 629241 Fax: 01904 620072
http://www.jrf.org.uk

ISSN 0958-3084

The Joseph Rowntree Foundation is an independent, non-political body which has supported this project as part of its programme of research and innovative development projects, which it hopes will be of value to policy-makers and practitioners. The findings presented here, however, are those of the authors and not necessarily those of the Foundation.