FUNDING SMALL BUSINESSES: CDFIS THEIR ROLE AND EXPERIENCE IN US AND UK.

It’s said that when the US sneezes, the UK catches cold. But we also have the US to thank for a model of finance that supports businesses in a way that the banks are not able to.

ART Business Loans (ART), established in 1997, lends throughout the West Midlands and adjoining counties with a mission to support enterprise and underserved areas and communities.

Its model – raising money from a variety of public and private sources to lend in a specific area - is based on the Community Development Finance Institution (CDFI) and Development Banking sector in the United States, with inspiration also being drawn from Birmingham’s twin city of Chicago and its South Shore Bank.
25 years ago, ART was the first of its kind in the UK. I believe it is again timely to compare the development of the CDFI sector in the UK versus the US and note some of the differences, challenges and opportunities that exist.

What are CDFIs?
CDFIs are social enterprises (organisations not for personal or shareholder profit) that lend to assist their local communities, whether that be in lending to individuals or businesses, with the primary aim of boosting local economies and achieving a positive social impact. In the United States many of the CDFIs and Development Banks have concentrated on lending for housing,

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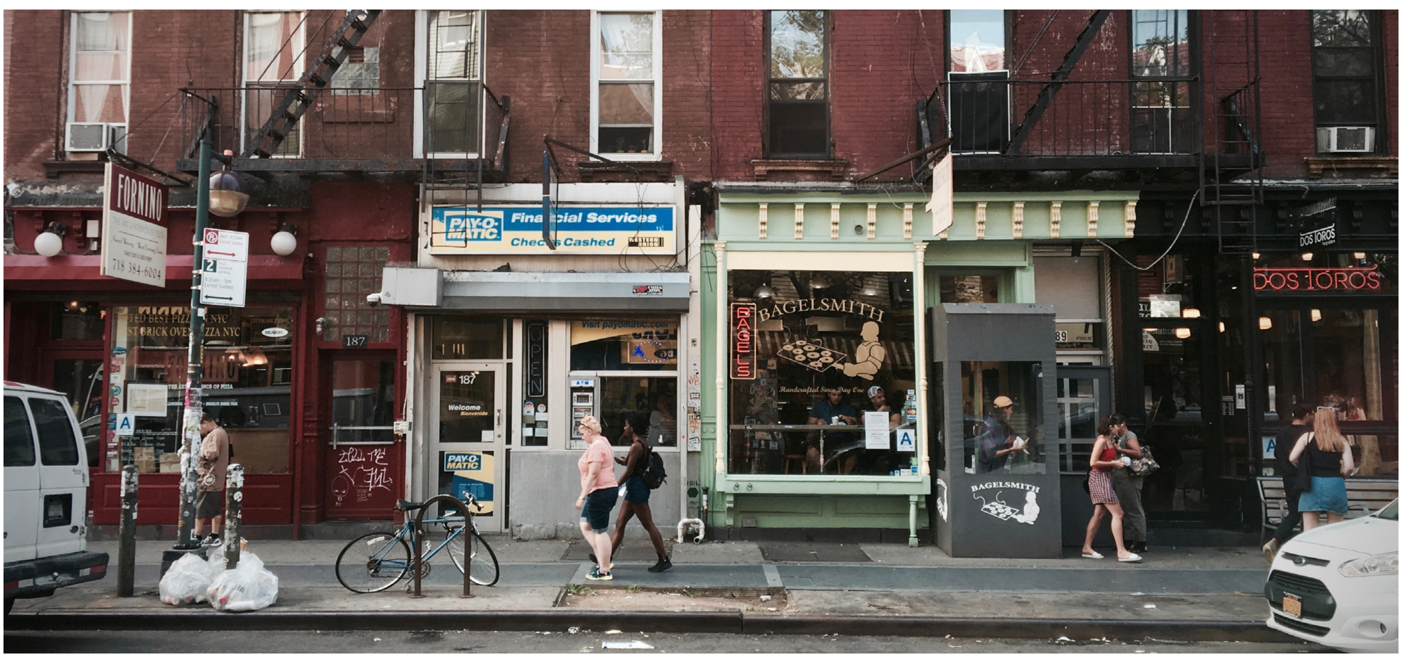

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which in the UK has not been a major need. The UK CDFI sector has split to serve two key markets: consumer finance, targeting gaps otherwise filled by loan sharks and high cost lenders, and enterprise lenders, targeting gaps left by the banks. They are an additional source of finance rather than an alternative.

The enterprise lenders either lend their own funds or provide a delivery service for funders such as British Business Bank's Start Up loan programme.

Some lend very small amounts to mainly start-up businesses, but most lend in the range between £10,000 and £250,000, where it is usual for gaps to be prevalent especially in the underserved areas and communities which are a target market for CDFIs.

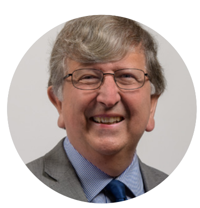
Scale and Funding

From my personal experience and visits to the US most people tend to assume that the CDFIs in the US are larger than in the UK, but in fact, because they concentrate their delivery in specific areas, as individual organisations are not much if at all bigger than their UK counterparts. However the way in which they obtain funds, both to operate and to lend, is significantly different.
The two essential requirements to raise capital for lending in the CDFI sector are a stable and consistent guarantee mechanism and some form of tax incentive.

In the US these have been available for many years, also supported by the Community Reinvestment Act (CRA) designed to evaluate banks' efforts to meet the credit needs of all people in their communities. If the banks closed branches and moved away from underserved areas and communities, the CRA pressed them to support CDFIs to take their place.

This initiative, despite much lobbying in the UK, has not transferred across the pond. Culturally, there is a greater wish to support CDFIs in the US, not only from banks and larger corporates, but also from local individuals, businesses, local authorities and foundations, which has not been easy to achieve in the UK.

The Impact Investment Institute (www.impactinvest.org.uk) provided a fascinating recent example from its research: New Hampshire Community Loan Fund is a US CDFI which concentrates on a population similar to Birmingham and Solihull or Leeds and Bradford combined. Looking at their annual report there are 14 pages of individuals, companies, foundations and charities who provide financial support in the form of gifts, loans or other



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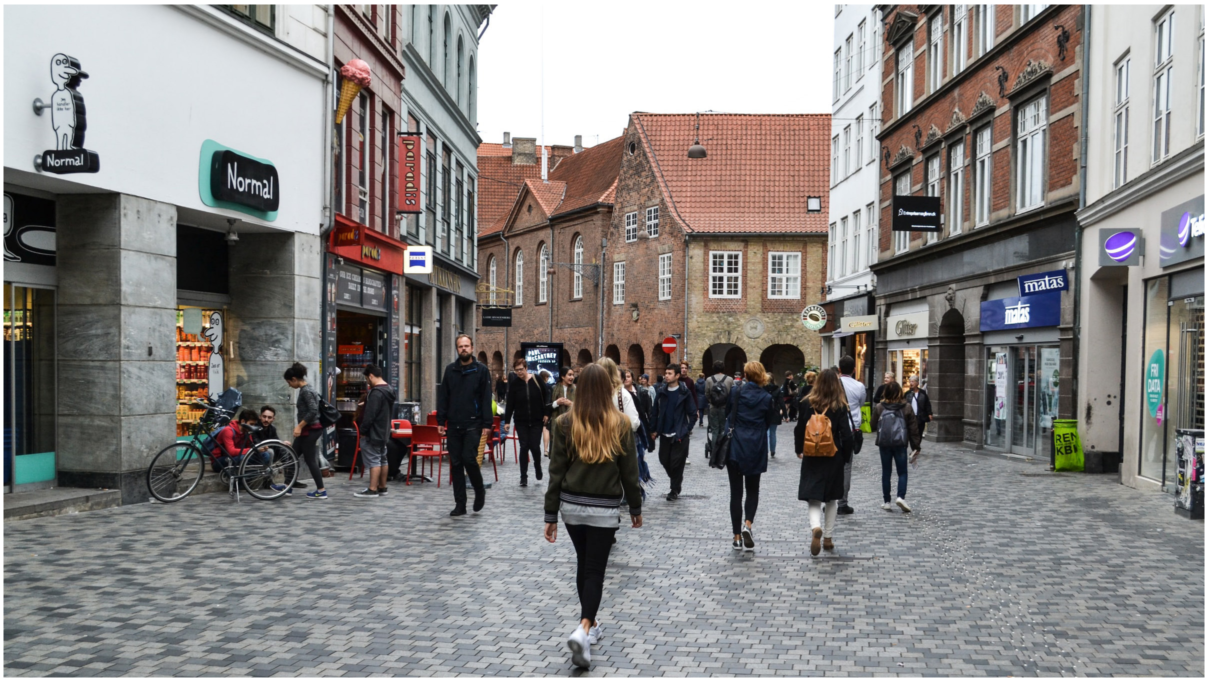

investments. For most Enterprise Lending UK-based CDFI, the list would be unlikely to fill a half page.

The introduction of Community Investment Tax Relief (CITR) in 2003 was based on a US initiative. Available only in relation to CDFIs in the UK, it provides investors and funders with a 5% deduction from their tax bill each year for five years.

It is a very useful tool, but has not been as widely used as anticipated.

The public sector has provided funding or guarantees in many different forms to support the CDFI sector over the years, at European, national, regional and local levels.

Most recently, CDFIs were included as accredited lenders for the COVID-related guarantee schemes which came from the Government via the British Business Bank. In addition, social investment supporters including Big Society Capital have increased the flow of funding to some CDFIs.

Looking to the Future

CDFIs now have a proven track record in the UK. They play an important role in a diverse, innovative finance market. Research shows lending supported by Government guarantees produces a benefit-cost ratio of between £7 and £11 for every £1 of taxpayer funds.

That's without accounting for the vast, positive social impact of CDFIs' loans in deprived areas and to disadvantaged groups. It is estimated that around 230,000 viable and well-established businesses, many led by female or black entrepreneurs, or based outside London and the South East, can't get the finance they need to grow every year.

The All-Party Parliamentary Group (APPG) on Fair Business Banking described a critical shortage of finance for small businesses.

So CDFIs are clearly needed as much today as they have ever been. Most businesses they lend to have previously been turned down by a lender, yet nine out of ten repay their loans, create jobs and grow their businesses.

I am delighted to say that 2023 has seen a first in the UK with a £2m social impact investment being made in ART by US corporate Block and matched by the UK's Unity Trust Bank working in partnership.

It is hoped this will lead the way for others to consider investment in the CDFI sector – whether in traditional or innovative ways.