OVERCOMING FINANCIAL EXCLUSION: COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS (CDFIS) AND THE BALANCING OF FINANCIAL AND SOCIAL OBJECTIVES

By

Lindsey Jemma Appleyard

A thesis submitted to

The University of Birmingham

For the degree of

DOCTOR OF PHILOSOPHY

School of Geography, Earth and Environmental Sciences

The University of Birmingham

September 2007

Overcoming Financial Exclusion: Community Development Finance Institutions (CDFIs) and the Balancing of Financial and Social Objectives

Lindsey Jemma Appleyard

Abstract

This thesis explores Community Development Finance Institutions (CDFI) as an alternative vehicle for the supply of debt finance to financially excluded enterprises. CDFIs are part of a broader approach to addressing financial exclusion that is experienced by commercial and social enterprises in the US and UK. The thesis explores US and UK CDFI lending processes to develop an understanding of how financial and social objectives are balanced in the lending process and the ways in which CDFIs become embedded in local financial and business support networks. The analysis is based upon detailed comparative research of CDFIs located in the US and the UK; interviews were undertaken with CDFIs, their clients and a quantitative analysis of a CDFIs loan portfolio was undertaken. The research concludes that CDFIs are complex dynamic organizations as they have to balance a double or triple bottom line which has the potential to undermine the firm's long term survival or mission. The danger is that over time a CDFI will reduce its exposure to risk and become more like a mainstream bank. The tensions with the CDFI business model implies that they will only ever provide a partial solution to the enterprise finance gap.

Acknowledgements

Whilst reading David Lodge's *Nice Work* for A-level, I was inspired to study at Birmingham University. It was not until I was completing my undergraduate dissertation with Dr Mark McGuinness at Bath Spa University that I realised that I could fulfil my ambition.

I would like to thank Professor John Bryson, Professor Mike Taylor and Steve Walker of ART for their direction and guidance. I would also like to thank all who participated in this research which would not have been possible without funding from the Economic and Social Research Council and my CASE sponsor.

The support from my geography postgraduate colleagues has been invaluable. But most importantly of all, a special thank you goes out to my family and Xenophon who have kept me smiling.

CONTENTS

FIGURES

TABLES

GLOSSARY OF TERMS

ART- Aston Reinvestment Trust

ASLP- Advantage Small Loan Programme

AWM- Advantage West Midlands

BCEF- Black Country Enterprise Fund

BCRS- Black Country Reinvestment Society

BEA- Bank Enterprise Award

BERR- Department for Enterprise, Business and Regulatory Reform (UK)

BOE- Bank of England

BBV- Bolton Business Ventures

CARS- CDFI Assessment and Rating System

CASE- Collaborative Awards in Science and Engineering

CDFA- Community Development Finance Association

CDFI- Community Development Finance Institution

CDP- Community Data Project

CITR- Community Investment Tax Relief

CDLF- Community Development Loan Funds

CRA- Community Reinvestment Act (1977)

CSR- Corporate Social Responsibility

CWRT- Coventry and Warwickshire Reinvestment Trust

DCLG- Department for Communities and Local Government (UK)

DTI- Department of Trade and Industry (UK)

EC- European Commission

ELSBC- East London Small Business Centre

ERDF- European Regional Development Fund

ESRC- Economic and Social Research Council

FDIC- Federal Deposit Insurance Corporation (US)

FSA- Financial Services Authority (UK)

HBOS- Halifax/Bank of Scotland

ICOF- Industrial Common Ownership Finance

INAISE- International Association of Investors in the Social Economy

IPS- Industrial and Provident Society

LETS- Local Exchange Trading Systems

NACDLF- National Association of CDLF

NCCA- National Community Capital Association

NEF- New Economics Foundation

NGO- Non-Governmental Organization

NMTC- New Markets Tax Credit

NSFNR- National Strategy for Neighbourhood Renewal (UK)

NSRCF- North Staffordshire Risk Capital Fund

OCC- Office of the Controller of the Currency (US)

ODPM- Office of the Deputy Prime Minister (UK)

OECD- Organization for Economic Cooperation and Development Group

OFN- Opportunity Finance Network

PAT- Policy Action Team (UK)

RDA- Regional Development Agency (UK)

SBA- Small Business Administration (US)

SBS- Small Business Service (UK)

SETF- Social Exclusion Task Force (UK)

SEU- Social Exclusion Unit (UK)

SFLGS- Small Firms Loan Guarantee Scheme (UK)

SITF- Social Investment Task Force (UK)

SME- Small-and-Medium-sized Enterprises

UKSIF- UK Social Investment Forum

CHAPTER 1 FINANCIAL EXCLUSION: SMALL FIRMS

Introduction

The purpose of this thesis is to explore the supply of funds available to support the activities of entrepreneurs[1], as well as commercial and social enterprises that are deemed by mainstream lenders to be unbankable. Enterprises that are unable to access finance are considered financially excluded[2], defined simply as 'those who lack financial products' (Marshall, 2004:241) or more correctly, those who are unable to access financial products including loan finance. Conversely, financial inclusion is where individuals and businesses can open a bank account and have access to credit facilities such as a an overdraft or credit card. Start-up enterprises may be unable to access finance as their founders may not have a track record, lack experience, have a poor credit history and limited wealth. The same also applies if enterprises seek finance to grow who cannot, for example, provide security to guarantee a loan that operate in high risk markets and declining markets.

This chapter first considers why enterprise, entrepreneurship and social enterprises are important in today's economy. The second part explores why enterprises require access to finance and the types of funding available and the sources of funding. The third part explores the enterprise finance gap and one solution, CDFIs. The final part outlines the structure of the thesis.

---

[1] Entrepreneurs are individuals who have established and currently manage a business.

[2] Social inclusion, on the other hand 'is about having the personal capacity, self confidence and aspiration to make the most of the opportunities, choices and options in life that the majority of people take for granted' (SETF, 2007:4).

Consequences of Financial Exclusion

The neoliberal strategies of successive US and UK governments have aimed to create jobs and to reduce the reliance on welfare support. One of these strategies aimed to stimulate and support enterprises in disadvantaged areas[3] through providing loans and business support as deprived areas have least access to finance. This thesis explores the role and relations of *Community Development Finance Institutions* (CDFIs) as an alternative vehicle for the supply of debt finance to enterprise. CDFIs serve the financially excluded by providing access to credit and in doing so, contribute to overcoming financial exclusion in which individuals and firms are denied access to various forms of financial products and loans for business start-ups and firms wanting to invest in developing their business activities. CDFIs work to a double bottom line by realizing social as well as financial objectives and can be defined as independent finance institutions that provide capital and support to empower individuals or organizations at the edge of commercial margins to develop opportunity and wealth in disadvantaged areas.

The UK New Labour Government's promotion of the Third Way's social and financial inclusion agenda, implies that it is advocating a retreat of the state as the UK system is shifting towards alternative forms of loan finance for both individuals and businesses rather then the provision of grants (Giddens, 1998). The UK is following the US model of making citizens responsible for their own welfare using public finance to support businesses that create jobs rather than directly supporting the unemployed. In spite of

[3] Deprived or disadvantaged areas are characterised by multiple indices such as poverty, high unemployment, low skills, poor health and housing, and a lack of geographical access to goods and services (Troni & Kornblatt, 2006).

dramatic economic change over the 20th Century, community finance has become instrumental in providing financial products and services to individuals and firms. For community finance institutions to remain viable in the long term they have to be innovative and diversify to adapt to changing policy market and economic conditions.

One solution to the enterprise finance gap in the US and UK has been developed and provided by Community Development Finance Institutions (CDFIs). CDFIs are an alternative vehicle for the supply of debt finance to financially excluded enterprises in deprived areas (Bryson and Buttle, 2005; Leyshon & Thrift, 1994; Mayo *et al*. 1998; Marshall, 2004; NEF and Nicholson, 2003). These institutions are involved in relatively high risk lending and consequently have to manage relatively high default rates. In many respects, CDFIs are an alternative to providing firms with grants. They use criteria developed in the mainstream financial institutions but modify them to target financially excluded enterprises and to include social criteria. Loans sanctioned by CDFIs are re-lent on repayment which multiplies economic wealth in the local community. In this way, CDFIs minimize risk and maximize social impact by operating revolving loan funds. This means that grant finance can be targeted at CDFIs as they will try to ensure that the funding they receive is re-circulated around the local economy. In this way, CDFIs could be largely responding to a set of policy objectives regarding financial exclusion and enterprise. This research aims to explore the different ways in which CDFIs operate to understand how effective they are in addressing financially excluded enterprises.

There is an unequal geography of CDFI provision as many CDFIs have been established by local volunteers rather than being the product of an organized movement to ensure equal access to CDFI services throughout the US and UK. High default rates and a gap in the provision of financial resources implies that CDFIs only contribute to overcoming financial exclusion in some parts of the US and UK. Due to their double bottom line, CDFIs are highly complex and so tensions within their operations will always exist. CDFIs must be financially viable and as such they do not finance extremely high risk business propositions. This means that financially excluded firms that operate below the lending threshold set by CDFIs will remain financially excluded. As such, one does not know the true size and scale of the finance gap. There is also self exclusion due to cultural norms such as firms that follow Islam and comply with Sharia law and the restrictions it places on interest payment.

The aims of the research are to:

1. Understand how ART provides access to finance and how it bridges the gap between fulfilling social objectives and economic purposes.
2. Define how CDFIs in the UK and US identify and measure effectiveness of socio-economic criteria that drive the business.
3. To compare ART with other UK and US CDFIs through benchmarking.
4. Consider the processes in which CDFIs become embedded in local financial and business support networks.
    - How effective are CDFI networks?
    - How do the networks operate and under what conditions?

5. To identify best practice to develop and inform other UK CDFIs.

Enterprise plays a significant role in the US and UK economies, particularly in terms of creating jobs and start-ups, as these economies are becoming increasingly fragmented. Yet lack of access to finance can restrict new enterprise formation and firm growth and can constrain the creation of jobs in deprived areas. Nevertheless, 'boosting enterprise…has been a recurring goal of [US and UK] Government policy' to generate local wealth, particularly in deprived areas (Troni and Kornblatt, 2006:v). Financial exclusion is linked to space and place which combine to intensify the severity of the situation. The impact of financial exclusion has intensified, especially in deprived areas of the US (Dymski and Veitch, 1996) and UK, through alterations in the way in which the mainstream financial sector assess loan applications from small firms (Buttle, 2005; Leyshon and Thrift, 1999; Martin, 1999). Here it is important to distinguish between financially included firms that can access loan finance and a group of sub-prime borrowers. This thesis explores one aspect of the sub-prime loan market in the US and UK. Sub-prime borrowers are conventionally ignored by mainstream lenders given risk levels. Sub-prime lending is usually ignored but has recently become extremely important given the relationship between sub-prime loans in the US and the impact on access and cost of finance in the mainstream financial markets. The US sub-prime financial crisis was driven by mainstream lenders providing high risk loans to sub-prime lenders. CDFIs are sub-prime lenders, but the limited extent of their activities and their distance from the mainstream financial system means that they have a limited impact both in terms of financial inclusion and on the wider financial system.

There are two types of enterprises; commercial enterprises and social enterprises. Commercial and social enterprises have different goals, for example, commercial enterprises may be managed to maximize growth, whilst social enterprises tend to be more concerned with their status quo. Small commercial enterprises fall into three categories:

1. Micro-enterprises: companies with 10 employees or less
2. Small enterprises: companies with 50 employees or less
3. Medium enterprises: companies with 250 employees or less (EC, 2007:1).

Collectively they are referred to as small-and-medium-sized enterprises (SMEs). Start-up businesses, regardless of whether they are social or commercial enterprises, are those that are less than three years old and established businesses are over three years old. Both start-up and established SMEs can be affected by issues of financial exclusion.

Social enterprises are organizations that have a social mission as well as a financial mission. They can be for-profit or not-for-profit but are driven by reinvesting surplus into the business, community, or to support their mission instead of being motivated by maximizing profit for their own benefit (BOE, 2003). It is worth noting that some social enterprises are driven by profit maximization, but only to ensure that they are able to maximize their social mission. Social enterprises often provide facilities not delivered by the state, such as forms of extra care provided for the elderly, which are embedded in the local economy. In this way, social enterprises allow ideas and innovations to occur that could not be developed in the public sector. However, the public sector can reintegrate the services of social enterprises back into the public realm. Social enterprises have to demonstrate their financial sustainability to their stakeholders so that they can access grant or loan finance from mainstream financial institutions. As social enterprises are driven by social and financial objectives, they must be sustainable organizations with viable business plans and balance sheets but they must also deliver a range of social, economic or environmental objectives. Social enterprises may have ‘a higher cost base’ than purely commercial firms as a result of their social mission (BOE, 2003:3). Given the higher cost of social enterprises, they may subsidize their social activities with other business activities. External interested parties (Government and charities), may subsidize the cost of balancing these organization’s social and financial objectives.

The Significance of Enterprise

Since the 1980s successive US and UK Governments have asserted that small business enterprises are the backbone of these economies as they stimulate employment, increase productivity and innovation in a globally competitive dynamic marketplace (NEF and Nicholson, 2003). Access to finance for SMEs is key to encouraging competition and economic growth in the UK. SMEs provide 58% of private sector employment and 52% of private-sector turnover (SBS, 2003). As such, SMEs play a significant role in the UK’s economy. Government policy has adopted a neoliberal approach which involves a shift away from welfarism to a policy framework that attempts to make their citizens responsible for their own wellbeing. The current UK Labour Government, for example, encourages women to go back to work when their children are at school (Wintour, 2007); this is one way of getting people off welfare benefits and into employment and even self-employment. It also promotes new opportunities for people to start their own businesses.

The economy has become increasingly fragmented largely through the corporate shift towards outsourcing and the ongoing division of labour associated with the development of the service sector (Bryson *et al*. 2004). Both processes provide opportunities for the development of new businesses. In addition, constant social change has provided new opportunities for people to do business. For example, the increasing interest in organic food has opened up new markets and business opportunities. The ongoing fragmentation of economic activity is dependent on the activities of educated people and their ability to access finance both for their start-up, development and growth. Many new revenue-based business opportunities have reduced entry barriers compared to manufacturing. Such firms have limited requirement for capital and equipment as they are based upon expertise and reputation.

Funding Enterprise

SMEs require both capital and revenue funding or cash-flow. Capital funding is required for the business to operate such as to acquire stock, computers, and furniture, while revenue funding is required for day-to-day activities such as salaries, rent, and insurance. Start-up costs also need to be covered as initially a business may not create enough revenue to support the owner and any employees.

Demand: How Small Firms are Funded

The first in-depth study of UK SME mainstream finance was undertaken in 2004 (Fraser, 2004). The study led by the *Bank of England* collated data on the availability and types of finance used by SMEs. The sources of finance used in the survey were all mainstream sources and ignored alternative sources of finance, for example, CDFIs. The study found that the most popular types of finance used by UK SMEs were overdrafts (52.9%) and credit cards (55.3%) (Table 1.1). Personal finance is used by enterprises to fund an SME's activities, which is a prime source of capital for entrepreneurs. UK SMEs were least likely to use equity based transactions, such as informal finance from friends or family, or formal investment from venture capitalists or business angels[4] (Table 1.1). In 2004, the average amount of loan finance sought by UK SMEs was £81,826 (Table 1.2). In comparison, UK ethnic-minority owners of SMEs only sought an average of £28,231 (Table 1.2). Of those businesses that sought external finance, 11.4% of UK SMEs were rejected outright from accessing bank loans, overdraft facilities, asset finance, or equity finance (Table 1.3). 19% of UK SMEs were awarded less capital than was requested and 8% (130,000) of SMEs were discouraged from applying for finance as they considered that their application would be declined (Fraser, 2004:12). However, in the majority of cases, no reason was given for the decline (Fraser, 2004:68). Some firms also self-define themselves as being financially excluded as they do not approach banks. These figures provide some indication of the extent of the enterprise finance gap in the UK.

Table 1.1: Type of Finance used by UK SMEs (%)

	Overdrafts	Grants	Term Loan	Asset Finance	Asset-based	Credit Cards	Equity
All businesses	52.9	6.4	24.3	26.9	3.0	55.3	2.9

(Source: Fraser, 2004: 156)

[4]Business angels are largely individual investors who are prepared to invest equity (less than £50,000) and experience based on their own successful business ventures on an informal basis (Mason & Harrison, 1999; Storey, 1994; Van Osnabrugge, 2000).

Table 1.2: Amounts of new finance sought in last 3 years by UK SMEs

	Amount Sought (£)
All businesses	£81,826
Non-white ethicity businesses	£28,231
White ethnicity businesses	£85,366

(Source: Fraser, 2004:169-170)

Table 1.3: Percentage of UK SMEs needing new finance which were rejected outright from applying for finance (bank loan, overdraft facility, asset finance, asset based, business angel or venture capital) in last 3 years (%)

	Rejected Outright	Partial Rejection	Discouraged
All businesses	11.4	19.0	8.2

(Source: Fraser, 2004: 172)

Supply: The Business of Providing Funds

Mainstream finance is provided by banks, venture capitalists and business angels, who all work to achieve a single bottom line of maximized profits. Mainstream finance is defined in terms of the availability of conventional products such as deposits and credit. Mainstream banking is provided by private business and their focus is on making a profit. For instance, in the financial year 2006 to 2007 *Barclays*, a mainstream UK bank, saw their profits increase by 35% on the previous year's trading, earning £7.136 billion before tax. Banks make short-term loans if clients have sufficient collateral to guarantee repayment and have the right risk profile (Taylor and Thrift, 1983). Thus, mainstream financial services exclude particular people and businesses that do not have the right credentials from accessing their services. By excluding certain groups, mainstream banks minimize the risk of losing money by borrowers defaulting on loans. Risk is minimized through securing the loan against property to guarantee that the loan can and will be repaid in full.

Recommendations made in the *Macmillan report* (1931) led to improved access to finance for SMEs but financial exclusion experienced by enterprise never disappeared. The Bank of England's (BOE, 2000:v) report on *'Finance for Small Businesses in Deprived Communities'* asserted that a number of elements contribute to increased risk and the reluctance of US and UK banks to sanction loans to 'marginal and near bankable businesses' in disadvantaged areas. The factors which make banks less likely to lend to enterprises in deprived areas include information asymmetries including:

> 'Lack of business experience; lack of collateral and personal equity; concentration in business sectors subject to higher failure rates; remoteness; small and localised markets; and high crime rates.' (BOE, 2000:v)

Information asymmetry is where information is missing or cannot be produced. The reluctance of mainstream financial institutions to lend to small businesses can be regarded as market failure and/or credit rationing. Mainstream banks lend on the loans of a system of credit scoring and risk assessment in order to increase profit and reduce the risk of borrowers defaulting on their loans (Barr, 2005; BOE, 2000; Leyshon and Thrift, 1999). The greatest impact of credit rationing is experienced by the most economically vulnerable who are asset and income poor and living in the most deprived areas. Of those self-employed people in disadvantaged areas with a personal current account, many do not have a separate business account. Individuals, micro enterprises, SMEs, and social enterprises in deprived areas have the least access to finance due to the risks involved in lending to them (Mayo *et al*. 1998; NFSNR, 1999). This means that the provision of finance for enterprise is geographically uneven and needs to be explored by economic geographers. National and local strategies to overcome financial exclusion, such as CDFIs, also have distinctive geographies that should be the subject of detailed research and form one element of analysis.

The Finance Gap

Market failure occurs where there is a demand for business finance but the supply is restricted by lack of deal flow and an unwillingness by lending institutions to lend to viable propositions. A finance gap exists where there is demand for finance but no supply. This implies that viable business propositions may exist which are never developed because they are considered to be unbankable business propositions. This leaves a finance gap in the market that can be filled by the activities of the state, by charities or by the development of various forms of micro-finance or community finance. The latter includes CDFIs. CDFIs can be considered to be an alternative financial vehicle as they help individuals and firms that have been financially excluded by mainstream financial providers. This thesis explores the role and actions of CDFIs as an alternative vehicle for the supply of debt finance to enterprise.

The existence of finance gaps for SMEs in advanced capitalist economies has been well documented (Barr, 2005; BOE, 2000, 2004; Bolton, 1971; Cole *et al*. 2004; Gertler, 1988; Graham, 2004; Macmillan, 1931; Martin, 1999; Mayo *et al.* 1998; Radcliffe; 1959; Stiglitz and Weiss, 1981; Storey, 1994; Taylor and Thrift, 1982, 1983; Wilson, 1979). A finance gap is defined as:

> 'an unwillingness on the part of suppliers of finance to supply it on the terms and conditions required by small businesses' (Storey, 1994:239).

The issue is one of access to a product and the attached conditions and cost. Small firms that have problems accessing capital are experiencing market failure and/or credit rationing (Storey, 1994). If SMEs cannot access business finance, then personal finance may be used in the form of credit cards, mortgages and/or personal loans. The existence of a finance gap suggests that mainstream financial institutions are reluctant to lend to small businesses that do not have the right business track record, lack collateral or are considered high risk from the perspective of lenders trying to minimize risk and maximize profit.

The supply of funds for enterprise was uneven resulting in forms of financial exclusion. Taylor and Thrift (1983:31) suggested that there were three finance gaps for enterprise: the first gap is access to banking capital; the second gap is the venture capital[5] gap; and the third gap is the international finance gap. But, there is also a fourth finance gap, a start-up gap that overlaps with personal financial exclusion as many start-up small firms are financed by personal financial products.

[5] Venture capitalists provide equity finance to businesses. Venture capital is defined as finance provided by professional investors of more than £50,000.

Many viable firms experience problems in accessing finance from mainstream financial institutions as potential lenders may not expect them to produce the expected return on investment associated with the level of risk involved. Viability is ‘where the expected return to the project exceeds the real costs of resources used’ by the financial institution (Storey, 1994). Vitality is the financial institution’s probability of securing a profit on a lending transaction. SMEs are perceived to be high-risk, expensive ventures for the size of loan that they require and part of the expense is linked to the management and administrative costs associated with smaller transactions. Barriers to accessing finance for enterprise are highlighted in Table 1.4.

Table 1.4: Reasons for the Financial Exclusion of Enterprise from Accessing Mainstream Finance

Reasons for the Financial Exclusion of Enterprise
• Start-up businesses
• High technology businesses
• Diversifying businesses
• In need of working capital, research and development, and/or marketing finance
• Lacking security
• Lacking a business track record
• Lacking management experience/skills
• High transaction costs
• Poor credit history and/or County Court Judgements (CCJs)

(Source: Nicholson, 2004:8)

Businesses can experience problems in accessing finance due to a lack of business experience, lack of collateral, if there is a high failure rate of businesses in that market, small, weak or localized markets, isolation and or high crime rates (Nicholson, 2004). Barriers to accessing personal finance include: receiving welfare benefits; being on a low income; unemployment; not owning property; being a single parent; age; having a criminal record; being from an ethnic minority background and/or living in a deprived area (Nicholson, 2004:9). As such, many businesses and individuals require business advice combined with financial support.

Many charities and voluntary groups face barriers in accessing mainstream finance. The supply of finance for social enterprises is problematic as many are at the margins of commercial viability as defined by the banks and many are not investment ready[6]. Social enterprises have a cultural aversion to debt finance, as they may have developed within the context of a grant rather than loan environment and culture. Grants often carry restrictions on the use of funds which constrains an organization's activities (BOE, 2003). Project based loans and grants may be problematic as they create short-term funds and instability especially when projects are paid in arrears. Grant funding does not motivate social enterprises to look beyond the short-term or to improve the operational efficiency of their business.

[6] Investment readiness is when firms searching for finance have viable business plans and business knowledge (Mayo *et al*. 1998).

Solutions to the Finance Gap

In recognition of the significance of SMEs, academic and policy makers have called for improvements in the supply of finance for many decades (Deloitte and Touche, 2002). So, why should the finance gaps that exist be removed and how could those gaps be filled? Access to finance is fundamental to enterprise development and growth (BOE, 2003) and internationally as well as locally competitive businesses need finance. Since Macmillan (1931) identified the first finance gap, the state has sought to resolve access to finance for enterprise. Yet the state has had an unhappy history of providing solutions to this problem.

Alternative sources of finance have emerged in response to the unwillingness of mainstream financial institutions to serve certain groups. Fraser (2004) identified that some businesses (8%) could not access finance but he ignored the financially excluded as well as the role of alternative sources of finance in the provision of finance for enterprise through organizations such as CDFIs. There is a gap in the existing literature on finance in regard to the provision of alternative finance for enterprise and the role of CDFIs. One of the most important contributions to this literature is Buttle's thesis on CDFIs, but the focus is primarily on the provision of finance for social enterprises. Marshall (2004) provided a literature based account of US and UK CDFIs. Buttle (2005) explored UK CDFIs as a form of social investment rather than as a source of finance for commercial enterprise. Benjamin *et al*. (2004), Rubin with Zielenbach (2006) and Rubin and Stankiewicz (2001) have worked on US CDFIs. One type of alternative to mainstream banks is a group of lenders that often incorporate a double or even triple bottom line in that they seek to fulfil social, environmental as well as financial objectives. These alternative lenders experience a tension that must be reconciled as they operate in line with mainstream lending practices yet also incorporate socially inclusive policies intended to serve the needs of the financially excluded. The aim of these alternatives is, however, for those who are financially excluded to eventually become part of the mainstream once that they have proved that they are bankable.

Alternative finance is also known as community finance, which includes co-operatives, friendly societies and credit unions, as well as pawnbrokers, licensed doorstep credit companies and illegal loan sharks (Palmer with Conaty, 2002). With the rationalization of banks in the UK, credit unions, a form of community finance institution, ‘potentially offer a more stable financial and institutional presence for people in those localities, especially those on low incomes’ (Fuller and Jonas, 2002:87; Fuller and Jonas, 2003; Palmer with Conaty, 2002). As such, Fuller and Jonas (2002) believe that the longevity and significance of credit unions is due to the fact that they are culturally and geographically embedded in local environments. The current UK Labour Government views credit unions as independent, alternative forms of finance which are thought to be a key to addressing social and financial inclusion (HMT, 2004). This thesis, however, does not consider Local Exchange and Trading Systems (LETS) (Amin *et al*. 1999, 2003; Burns *et al*. 2004; Lee, 1999; Leyshon *et al*. 2003; Williams, 1996; Williams *et al*. 2004), credit unions (Fuller and Jonas, 2002, 2003; Purcell and Cobb, 2004), co-operatives, friendly societies, pawnbrokers, licensed, or unlicensed credit services, as they focus on overcoming personal financial exclusion rather than financially excluded enterprises.

This is an important distinction; credit unions enable people to borrow to fund personal consumption whilst providers of finance for enterprise directly contribute to local economic development and wealth creation.

Geographers have predominantly been concerned with the use of finance and have also focused on understanding personal finance and alternative finance (for example Amin *et al*. 1999, 2003; Fuller and Jonas, 2002; Lee, 1999; Leyshon and Thrift, 1997; Leyshon *et al*. 2003; Williams, 1996; Williams and Windebank, 2001; Williams *et al*. 2003). The alternative finance literature focuses on exploring local demand for personal finance and financial exclusion. There has, therefore, been minimal effort to explore the supply of finance, particularly for enterprise. The absence of a significant body of literature in geography on finance for enterprise is perhaps explained by the difficulty of working within firms as well as financial institutions, and the cultural turn which highlighted the importance of exploring diversity and alternatives other than the mainstream (Burns *et al.* 2004, Leyshon *et al*. 2003; Williams and Windebank, 2001). Similarly, the recent ‘relational turn’ in economic geography encourages academics to develop a people-centred rather than enterprise-based approach to the firm (Hess, 2004). This means that banks or lenders to enterprise have been neglected.

Financial exclusion for enterprise is not necessarily visible, whereas personal financial exclusion can be highly visible due to the retreat of banks from the high street and the multitude of pawnbrokers, cheque cashing, and credit unions. The visibility of personal financial exclusion is perhaps the UK version of US redlining[7], where banks do not serve deprived communities. In the late 1980s, mainstream banks retreated from inner city areas to more wealthy and profitable areas, thus excluding the poorest in society from accessing financial products and services (Buttle, 2005; Leyshon and Thrift, 1994, 1997, 1999; Williams, 1996). This suggests that there is an obvious spatiality of personal financial exclusion which has promoted the development of a geographical literature on personal financial exclusion.

US and UK CDFI Comparison

In this thesis a comparative approach developed through the analysis of US and UK CDFIs. This approach was taken to understanding the emergence and development of CDFIs in the US and UK rather than making a straight comparison. No empirical comparison between US and UK CDFIs has been undertaken. The intention of this thesis is to provide the evidence base for US and UK CDFIs, and explore how and why CDFIs, located in different places, work to foster enterprise in different ways. This analysis explores the ways in which marginalized enterprises can access finance through CDFIs to maximize enterprise activity in the US and UK. US CDFIs emerged in the 1960s as a result of local banks shifting their interests to global markets through the deregulation of the banking sector. US CDFIs are perhaps better developed than those in the UK. UK CDFIs have taken a more balanced approach to their activities seeking to balance social and financial objectives. In this way, this thesis explores different solutions that have been developed to overcome the problem of financial exclusion. US CDFIs are radically

[7] Redlining is the term used to describe the process by which a red line is drawn on a map to highlight low-income areas to deny access to credit and mortgages to the communities within that location (Pinsky, 2005).

different to those in the UK and this analysis identifies and explores those differences. Against this background, the analysis addresses US and UK CDFIs by exploring the following issues:

- In what ways, if any, is financial exclusion being tackled by CDFIs and how are CDFIs becoming embedded in the local environment to ensure that they reach their target market through the articulation of a double bottom line?
- How do CDFIs define and measure their double bottom line?
- How do CDFIs become sustainable?

This section has explored how SMEs are funded, if at all and the issue of the finance gap which has led to alternative forms of finance emerging to aid enterprises that cannot access mainstream finance. The next chapter will highlight the gaps that exist within the literature that deal with the geographies of finance. These questions are placed in the context of the literature that has developed on the geographies of finance and it is a consideration of the gaps in this literature that we now turn our attention.

Thesis Outline

This chapter has outlined the key theme of this thesis, the financial exclusion of enterprises in the US and UK as a result of a finance gap that is created by the action of mainstream financial institutions. ‘Access to Finance: Small Firms’ provides the theoretical foundation for this research and explores the literature on the geographies of finance surrounding small firm operations and the supply of finance from mainstream financial institutions and alternative economic spaces to explore where, how and why CDFIs can be situated within these debates.

The methodology for the thesis is outlined in Chapter 3, which explores in detail how and why particular qualitative and quantitative techniques were selected in order to access and analyze the interview and CDFI loan portfolio data. Interviews with banks, CDFIs, CDFI clients and CDFI trade associations were undertaken to consider a broad spectrum of key actors and stakeholders within the sector.

Chapter 4 ‘The state of the CDFI sector in the US and UK’ explores the historical context of US and UK CDFIs and the current debates surrounding CDFIs and their activities. The chapter explores both how US and UK CDFIs emerged in a series of three, albeit different phases reflecting different policy contexts and the roles that CDFIs play in these countries. Chapter 4 provides the context for Chapter 5, the first empirical chapter.

The nature of the operations of US and UK CDFIs is considered in Chapter 5 ‘The nature and operations of US and UK CDFI case studies’. The operations of CDFIs within and between the US and UK differ markedly as they emerged in different ways, in response to a different set of drivers, have various different roles (and missions), serve different markets and as a result, their performance measurement reflects the difference, diversity and complexity within the US and UK CDFI sectors.

In Chapter 6, the embeddedness of US and UK CDFI operations and the tensions within balancing their financial and social objectives is explored. Chapter 6 also explores the flow of funds into, within and out of CDFIs to reveal how CDFIs try to balance their social and financial objectives, if at all.

In Chapter 7 the dynamic complexity involved in balancing CDFI operations within a regional context is explored through a detailed case study, the *Aston Reinvestment Trust* (ART), a CDFI based in Aston, Birmingham, UK. The chapter shows that US and UK CDFIs operate using a triple bottom line of social, financial and environmental objectives given the geographical nature of their operations, rather than balancing the usual double bottom line.

Chapter 8 concludes the thesis. At present US and UK CDFIs are geographically uneven, use different business models and organizational structures, serve small, local, niche markets and are dynamically complex. US and UK CDFIs may never achieve the scale to have a significant impact on financial exclusion as they are not a coherent sector. Without a consistent approach to providing access to finance, it is unlikely that UK CDFIs will create the impact desired to reduce the financial exclusion of enterprises.

This thesis contributes to the existing literatures by exploring access to finance for enterprises that are at the margins of commercial viability. The research undertakes a comparative study of US and UK CDFIs to explore the differences within and between CDFIs operations.

CHAPTER 2 ACCESS TO FINANCE: SMALL FIRMS

Since the 1970s, geographers interested in finance have concentrated their activities on exploring access to mainstream finance for personal consumption, financial restructuring and bank branch withdrawal in the US and UK (Dymski and Veitch, 1996; Leyshon and Thrift, 1994, 1996, 1995, 1997, 1999; Martin, 1999). One emphasis has been on bank retreat, for example:

> 'In the late 1980s and early 1990s in response to a financial recession the high-street banks re-orientat[ed] themselves up-market and…[closed] many of their inner city branches' (Buttle, 2005: 144).

Mainstream banks in the US and UK have focused on their bottom line[8] and restructured their operations away from disadvantaged areas (Williams, 1996). The literature on personal banking is paralleled by alterations in the way that banks process applications for enterprise loans. Retail banks have shifted their business lending procedures away from face-to-face relationship banking to credit scoring to determine the lending risk and the profitability of each loan (Leyshon and Thrift, 1999). The rationale for using credit scoring is to overcome information asymmetries[9] and identify customers that will be more likely to repay loans from those that will not (Leyshon and Thrift, 1999; Stiglitz and Weiss, 1981). In this way, mainstream financial institutions seek to reduce the risk of loans defaulting and to increase their profitability. The use of credit scoring arguably exacerbated financial exclusion as banks have become increasingly risk averse (Leyshon and Thrift, 1999).

---

[8] The bottom line of commercial enterprises is to generate a profit.
[9] Information asymmetries are where information is missing or unknown.

With the withdrawal of financial services from certain areas of the UK (Buttle, 2005; Bryson and Buttle, 2005; Leyshon and Thrift, 1994, 1995, 1996, 1997, 1999; Martin, 1999; Williams, 1996), economic geographers have concentrated on understanding, alternative economic spaces and in particular, alternative financial initiatives that serve socially and financially excluded groups and local needs such as credit unions and Local Exchange and Trading Systems (LETS) (Amin *et al*. 1999, 2003; Fuller and Jonas, 2002; Lee, 1999; Leyshon and Thrift, 1996, 1997; Leyshon *et al*. 2003; Purcell and Cobb, 2004; Williams, 1996; Williams *et al*. 2003). Credit Unions are not-for-profit, independent financial co-operatives which are mutually owned (FSA, 2004; Hyndman *et al*. 2002). Credit union members are linked by a common bond of shared beliefs, religion, employment or community (ABCUL, 2002; FSA, 2004; Hyndman *et al*. 2002). In contrast, LETS are:

> ‘a system of exchange of services and skills amongst the members of a community. The form of money is essentially the valuation of the various services and skills that these members provide for one another’ (Lee, 1999:209).

In this way, LETS and credit unions are perceived as an alternative, socially constructed form of money which rely on social embeddedness and trust within a particular time and place in which to operate.

Economic geographers have also explored global financial systems (Clark, 2005; Leyshon and Thrift, 1996, 1997) and firms with high growth potential seeking venture capital (Mason and Harrison, 2002; Martin, 1999). Yet, geographers have neglected to develop geographies of finance for enterprise. Taylor and Thrift (1983: 359-360) suggest that geographers have ignored:

> 'the sources and types of funds available to different types of enterprise even though the availability of these funds obviously constrains all aspects…of investment decision making… a proper appreciation of the nature and availability of various forms of finance is, therefore, central to an understanding of the functioning of modern capitalist production'.

Even though Taylor and Thrift wrote this in the early 1980s, geographers have still not responded to this call for research on the supply of finance for enterprise. There is a significant gap in the literature on mainstream finance for enterprise. In particular, the access to debt finance for start-up and existing SMEs and the ways in which mainstream financial institutions operate their loan funds in order to maximize their single bottom line or profit.

Financial geographers have ignored the finance for enterprise gap (Pollard, 2003, 2007). Geography may have neglected to explore the enterprise finance due to the complexity surrounding finance for enterprise. The complexity derives from the variety of finance options available to firms which reflect the different requirements of each business sector and stage in the business cycle. Furthermore, in terms of the empirical research required to explore firm finance, it is difficult to access SMEs as entrepreneurs do not necessarily want to discuss their private financial affairs. Banks are also reluctant to discuss such matters as they operate within a dynamic market that reacts to changes in the economic cycle. In this way, access to banks and enterprise is challenging due to the sensitivity of the research material. Not surprisingly, there is a gap in the literature in the area of access to finance for enterprises, especially the uneven development of mainstream finance and for the availability of finance in disadvantaged areas.

This chapter explores SMEs and finance. The first part of the chapter defines small firms and examines the increasing significance of small firms in the economy. The second part of the chapter investigates the supply of finance through mainstream financial institutions. The rapid growth of the small firm population has led to a greater demand for external finance. Increased demand has been limited by supply problems, thereby creating a finance gap. As a result, many firms face barriers to accessing finance which sees them seeking alternative strategies and networks. The third section of this chapter explores the alternative economic spaces literature as one solution to the finance gap. By highlighting differences between mainstream and alternative lending practices, the final part of the chapter situates CDFIs within the economic geography literatures. The chapter concludes by arguing that a significant proportion of small firms in the UK continue to experience barriers to finance which impedes start-up rates and the efficiency and progress of many SMEs.

Small Firms

The key drivers behind small firms are entrepreneurialism and supportive public policy. A successful small firm will have a number of key entrepreneurial resources such as motivation, finance, skills, expertise and knowledge. A small firm also needs an appropriate external operating environment in terms of taxation and policy to allow the business to develop and grow. The operating environment includes investment, expenditure, cash flow, internal and external operating environment, and the market. Together the internal and external factors can determine the strategy and the success or failure of a small firm. This entrepreneurial process also applies to CDFIs and their clients, as a CDFI is a business in its own right.

Finance for enterprise is perhaps the key issue for small firms regardless of their development stage (start-up to post-growth). Accessing finance can be problematic for enterprises due to a lack of investment readiness. Investment readiness is defined in the following three ways:

1. The SME is seeking finance.
2. Business plans are complete and up-to-date.
3. The SME has a viable business proposition (Mayo *et al*. 1998).

The type of finance required can be divided further into capital or revenue finance. Loan capital funding is required to acquire capital (assets, land, machines) while revenue finance concerns a firms' operating budget and includes salary and running costs.

What is an SME?

The UK Government promotes SMEs as 'enterprise is a key driver of a modern, high productivity economy in which opportunity is open to all' (HMT, 2004:3.24). Enterprise is perceived to be essential in order to compete in the global economy and it revitalizes stagnant local economies (HMT, 2004; Porter, 1990). Porter (1990) asserted that SMEs are vital to local economies, especially those of the inner city as they can stimulate regeneration, particularly if small firms are embedded in the local economy (Taylor, 1999), as well as empowering those living and working in the inner city as enterprise can be seen as an opportunity to rise out of poverty. Academics and the US and UK Governments recognize that SMEs form a significant sector in advanced economies (Storey, 1994; Keeble, 1997). Entrepreneurialism has become a viable option for many due to the flexibility and diversity of the sector. This section, explores the definition of SMEs, the complexity of small firm activity, and the significance of entrepreneurship and SMEs for the economy.

Defining SMEs

SMEs have proved contentious to define and their slippery nature remains contested by national and international administrations, academia and financial institutions (Storey, 1994; BOE 2000, 2002, 2004; EC, 2002; Taylor and Asheim, 2001). To demonstrate the difficulty in defining the diverse nature of the SME, the *Bolton report* (1971) acknowledged that small firms cannot 'be adequately defined in terms of employment, or assets, turnover, output or any other arbitrary single quantity'. Storey (1994:8) agrees that there is:

> 'no single, uniformly acceptable, definition of a small firm…[as each sector has different] levels of capitalization, sales and possibly employment'.

Thus, 'objective' measures of small firms (profit, turnover, number of employees) depend upon the market sector in which the small firm is located (Storey, 1994:8). In an attempt to overcome these issues, the Bolton Committee (1971) developed two definitions of small firms: ‘economic’ and ‘statistical’ definitions, both of which are characterized by three key elements. The ‘economic’ definition of small firms is that: first, small firms have a minor market share; second, that they are ‘managed by [their] owners or part-owners in a personal way’; and finally, that they are an independent company which are not part of a larger firm (Bolton, 1971:1). Whilst the ‘statistical’ purpose of defining a small firm:

> ‘was [first] to quantify the current size of the small firm sector and its contribution to economic aggregates such as gross domestic product, employment, exports, innovation, etc. The second purpose was to compare the extent to which the small firm sector has changed its economic contribution over time. Thirdly, the statistical definition, in principal, has to enable a comparison to be made between the contribution of small firms in one country with that of other nations’ (Bolton, 1971:1).

However, according to Storey (1994), these two definitions conflict. According to the Bolton Committee (1971) a small manufacturing company can have up to 200 employees, whereas in construction or retail, the company can only have 25 employees or less to be defined as small. In contrast, the economic definition believes that a business is managed in a personal way. Storey (1994), quite rightly, questions whether this can be true of a company with 200 employees. In addition, there is no unifying concept of small firm and the turnover of small firms does not account for price fluctuations (Storey, 1994). Despite the best efforts of the Bolton Committee (1971), it is clear that small firms are difficult to define due to their diverse nature and complex operations.

The EC (2007:1) tried to overcome some of the problems associated with the depiction of small firms by identifying three categories:

4. Micro-enterprises: companies with 0-9 employees.
5. Small enterprises: companies with 50 employees or less.
6. Medium enterprises: companies with 250 employees or less.

This definition unifies SMEs through a single concept and incorporates all sectors of the economy (Storey, 1994). Hence the term SME will be used in this thesis. However, this definition fails to reflect the diverse nature of small firms, and ignores the social, cultural, political, space and time dynamics. Thus, the EC definition of SMEs still lacks credibility, although small firms can be compared efficiently across markets, regions and countries regardless of price fluctuations and changes to currency.

The Decline and Rise of SMEs

The small firm sector in the UK was in a state of decline until the late 1960s when the sector began to grow once more (Bolton, 1971). Small firms employed at least 6 million or 25% of the workforce in the late 1960s (Bolton, 1971), compared to 44% of private sector employment in 2003 (BOE, 2004). The rise of the small firm in the late 1960s could be a consequence of economic restructuring and the rise of deindustrialization of the UK's manufacturing sector (Martin, 1999; Storey, 1994). But the real turning point for the rise of small firms came in the 1970s, a decade dominated by economic crisis, deregulation and increasing globalisation in advanced economies (Martin, 1999). An increasing demand for specialist products associated with advances in technological innovation meant that small firms were more able to meet the needs of markets and realize economic growth (Storey, 1994; Van Osnabrugge, 2000).

The growth in the number of small firms was due to a number of factors. On the supply side, technological advances led to innovations and the creation of new products and services (Van Osnabrugge, 2000); the fragmentation of industry led to increased levels of subcontracting and buy-outs; education levels have increased and in times of high unemployment, self-employment has been viewed as a viable option. In addition, Government's have embraced the neoliberal philosophy of privatization and deregulation for the efficiency of the market which has led to a public discourse surrounding the enterprise culture (Storey, 1994).

On the demand side, economic restructuring with increased flexible specialization within manufacturing and the rise of the service sector has created niche markets (Storey, 1994). These factors led to a paradigm shift which essentially increased the significance of small firms for the vitality of the economy (Martin, 1999; Rogaly *et al*. 1999). It is widely believed that small enterprises are vital for job creation and economic vitality as they stimulate wealth within local economies (Acs and Storey, 2004). The 1980s were characterized by the rise of an aspiring 'enterprise culture' (Acs and Storey, 2004:871). Self-employment proved to be a viable option for those who were long-term unemployed or in low wage occupations and it was one method that could be used to shift them from the poverty trap (Rogaly *et al*. 1999) and it also sits comfortably with neo-liberal philosophy.

Entrepreneurship, Temporary Coalitions and Time

Over the last decade, advances have been made in understanding entrepreneurship as a tool for economic development through exploiting cross discipline debates from economics, geography and sociology (Acs and Storey, 2004). An entrepreneur is defined simply as someone that starts their own business. This definition is by no means adequate as it fails to take into consideration all the resources necessary to become an entrepreneur (Taylor, 1999). Arguably, entrepreneurialism only occurs once in the lifecycle of a firm and that is at the start-up stage. To set up a business requires skill, and/or experience, and knowledge.

To move away from the neoclassical definition of the firm as a 'black box', Taylor and Asheim (2001) argue that the firm can be conceptualized in two ways. The rationalist concept defines the firm based on efficiency measures (price) whilst the 'alternative' (Taylor and Asheim, 2001:4) socioeconomic concept of the firm places 'the social construction of the economy' (Taylor and Asheim, 2001:3) at its core. Polanyi (1957) developed the social concept of the firm approach and this has produced a number of other theories including:

> 'institutionalist, embedded networks, learning, resource-based, discursive [or relational] and temporary coalitions' (Taylor and Asheim, 2001:4).

These concepts are linked by the notion that enterprise is a dynamic mix of social and economic processes. This thesis employs the embeddedness concept of the firm, whereby economic activity is dependent upon the social, cultural, and political context surrounding the firm.

Linked to the concept of embeddedness is the temporary coalition perspective of the firm. A firm can be conceptualized as '*a networked temporary coalition*' between entrepreneurs who seek market opportunities (Taylor, 1999:1). 'New firms are, therefore, from the outset informally networked with other businesses' (Taylor, 1999:1). Temporary coalitions are networks of firms that operate through individuals and develop and vary over time. This thesis explores firms as temporary coalitions as it is believed that individuals are selected to join the firm (staff and board of directors) for their knowledge and expertise to develop and enhance the enterprise's missions over time and also considers the processes by which CDFIs become embedded in local financial and business support networks

In addition to this, the significance of time is often ignored, especially the timing of when, where, how and why a venture is established. These factors are entirely dependent upon the situation, environment and circumstances of the entrepreneur(s) as without the right finance, knowledge and capabilities, a firm would not exist. Acs and Storey (2004) suggest that entrepreneurs look for opportunities in the marketplace to transfer resources to improve the efficiency of the market (creating profit for themselves, and posing a displacement threat to existing enterprises), which itself is dependent upon time and space. Keys and Thrift (1980:117) assert that: 'if the environment itself is evolving then the timing of particular strategies for firm growth is crucial', as well as the social, cultural and governmental factors that can affect enterprise development. This illustrates that time is significant for firm creation, as time is specific to market opportunities, the pooling of resources, entrepreneurs and temporary coalitions.

Time plays a significant role in exploring enterprises and research as operations, processes, markets, and relations change constantly. Many theories ignore the role of time (George and Jones, 2000; Massey, 1999). Indeed, Marshall (1930:109) highlighted the significance of economic climate when addressing economic laws, when he stated that ‘time [is] the source of many of the greatest difficulties in economics’ as price changes according to demand which is also time specific. Time and space are interconnected (Massey, 1999; Schoenberger, 1997) and are significant in market dynamics, firm formation and developments in accessing finance. Space, time, and competition structure capitalism (Schoenberger, 1997). As such, the internal and external networks at a local and national level surrounding organizations are explored to illustrate how and why they are embedded within those networks in particular times and spaces.

This section has explored SME definitions and the increasing significance placed on small firms to increase productivity, wealth generation and stimulate the economy. Also, it is believed that through employment, society will become inclusive, reducing the need for welfare provision (Burns *et al*. 2004). This section has therefore outlined the role that small firms play in society and the economy and set the wider context for the research. The next section explores the issue of access to mainstream equity and debt finance for enterprise.

Access to Finance: Mainstream Financial Institutions

Geographers have overlooked that firms can experience problems in accessing finance for their business at start-up or growth stages (Pollard, 2003, 2007; Taylor and Thrift, 1983). The academic literature on small firm start-up and growth (but not the financial literature in geography) concentrates on access to finance (Evans and Jovanovic, 1989; Stiglitz and Weiss, 1981; Storey, 1994). This suggests that accessing finance for start-ups and high growth is critical yet it can prove difficult (Storey, 1994). Small firms require finance for working capital and/or investment expenditure, for example, for equipment, and machinery (BOE, 2002). The barriers to finance experienced by small firms often include creditworthiness and lack of collateral to act as security against the loan (Barclays, 1987; BOE, 2000; BOE, 2004; Cole *et al*. 2004; Gertler, 1988; Graham, 2004; Martin, 1999; Mayo *et al.* 1998; Stiglitz and Weiss, 1981; Storey, 1994). Yet few have dared to suggest how long it could take for small firms to establish creditworthiness and how they should do so if they have no collateral. As a result of barriers to finance, it can be a battle for SMEs to survive. Many entrepreneurs have inadequate resources to fund their business, and some do not have a track record of personal or business accounts never mind being able to provide collateral for a loan. Controversially, Evans and Jovanovic (1989) argue that only wealthy entrepreneurs are attracted to starting their own business due to their access to capital and are willing to accept the risks associated with business failure. Evans and Jovanovic (1989) conclude that liquidity constrains start-up rates of small firms, and wealthier people are more likely to become entrepreneurs due to their access to capital.

This section explores mainstream access to finance, first, by considering mainstream bank lending in the US and UK in terms of criteria, operations and performance. Second, this section explores the finance gap and the Small Firm Loan Guarantee Scheme (SFLGS) which aims to help businesses that are financially excluded. Third, the section explores the significance of equity finance, through venture capital and business angel activity.

US and UK Mainstream Financial Institutions

Banks are commercial businesses and are driven by generating a profit. As a result, their operations try to mitigate risk. Banking practices in the US and UK have shifted from a face-to-face relationship based on a qualitative loan assessment process prior to the early 1980s (Dyer, 1977) to a more formalised and rigorous quantitative process (Leyshon and Thrift, 1999). This is a quicker and arguably, more consistent and effective method of assessing risk in the lending process. Mainstream banks currently assess applicants using credit scoring, which takes account of the credit history of the business owner, the viability of the business plan, and the skills and experience of the entrepreneur (BOE, 2000; Dymski and Veitch, 1996; Leyshon and Thrift, 1999; Mayo *et al.* 1998). Credit scoring has become increasingly common for the credit assessment of small enterprises:

> ‘Credit assessment techniques…are a method of judging a credit applicant’s risk of default or delayed debt repayment by performing statistical analysis on the correlations between past account behaviour and other information and the applicant’s eventual repayment performance and use this as a basis to predict the new applicants’ likely future performance.

There is some evidence that use of these scoring techniques can increase the availability of credit to SMEs, speed up response times as well as enabling banks to manage risk better' (BOE, 2004:36).

Credit scoring requires evidence of a business track record, and at start-up many entrepreneurs do not have one. This can lead to information asymmetries, moral hazard, credit rationing, and adverse selection, simply because small enterprises are less likely to possess all the relevant information required for credit scoring (BOE, 2000; Cole *et al.* 2004; Gertler, 1988; Mayo *et al.* 1998; Storey, 1994).

Adverse selection occurs when banks increase interest rates to all borrowers, rather than identifying high risk and low risk borrowers (BOE, 2000; Storey, 1994). Adverse selection and information asymmetries can lead to credit rationing, and only those businesses that are prepared to pay the inflated cost of debt will be able to access loan finance (BOE, 2000). Moral hazard occurs when the loan defaults but an entrepreneur has no security cover, leaving the bank issuing the loan to cover the cost (BOE, 2000; Gertler, 1988; Storey, 1994). According to De Meza (2002) information asymmetries have led to moral hazard (optimistic lending) and overlending by banks, especially to those in disadvantaged areas who are often excluded from accessing finance. Some may be excluded from the system by what might be considered overly harsh, crude and mechanistic lending procedures. But the procedures are logical within the parameters set by the lenders and are designed to minimize risk and maximize profit.

The Mainstream Loan Application Process

According to a large UK retail bank (Barclays, 1987) loan applications should be assessed on the quality and accuracy of the information given by using the mnemonic CAMPARI (which it continues to use today). CAMPARI stands for; character, ability, margin, purpose, amount, repayment and insurance (i.e. security). 'Character' is assessed largely on the trust between borrower and the loan officer, as it gauges the accuracy of information stated on the application and, more importantly, whether or not the customer has the ability to repay the loan (Barclays, 1987). 'Ability' encompasses the degree 'to which a customer is successful in managing their financial affairs', which includes for example, their motivation, skills and qualifications applicable to the business and the viability of the loan (Barclays, 1987:8; Mayo *et al*. 1998; Storey, 1994). 'Margin' includes the viability of the loan in terms of it making the business (more) profitable. 'Purpose' is what the loan is for. 'Amount', applies to whether the loan size is too great or insufficient for the business to survive. In addition, banks require the owner(s) of the business(es) to contribute personal finance to the project so that any issues that arise once the loan has been accepted can be remedied easily through the safety net of the owners own funds. The repayment procedure should be clarified from the beginning of the loan process, as the business needs to be able to generate adequate funds to repay the loan as well as to be able to function positively (Barclays, 1987). This is otherwise known as an agency issue whereby it is the role of the bank to ensure that the borrower understands the loan process (Storey, 1994). Banks often take security in the form of assets (freehold property, business stock or equipment) as a form of insurance should the loan default (Barclays, 1987). Not all customers, however, can provide security which often excludes many individuals and businesses from the market. Despite the significant changes made in the mainstream banking sector, there continues to be a finance gap in the small firm market owing to the banks approach to finance and risk aversion to SMEs, particularly start-ups with no credit history.

Mainstream Financial Institutions Performance and Practice

The Bank of England has monitored the performance of banks since the 1990s (BOE, 2004). As a result of the economic recession at the end of the 1980s and early 1990s, 'there was a breakdown of both communication and confidence between many SMEs and their main financ[ial] providers' (BOE, 2004:33). This undermined many small firms' ability to function effectively as they tended to rely on short-term, overdraft finance whilst banks were changing their business practices by introducing credit scoring techniques into the lending process (BOE, 2004).

After a period of steady growth, and low inflation in the UK in the 1990s, small firm failure declined so banks became increasingly confident in lending to the sector (BOE, 2004). With a greater understanding of small firm needs, banks diversified their lending facilities (BOE, 2004). Although, bank loans to small businesses range from £1000, to an average of £7000 (Rogaly *et al*. 1999:113) banks remain loathe to lend such small amounts owing to high transaction costs and the high risk of business failure associated especially with start-up businesses (BOE, 2004; Rogaly *et al.* 1999; Van Osnabrugge, 2000). As a result, lending by banks to small firms has been rationed to particular types of loan products, for example (Rogaly *et al.* 1999). Storey (1994) suggests that by raising interest rates, credit rationing would not exist but this could lead to increased default rates. Stiglitz and Weiss (1981) suggest that information asymmetries are used to ration credit, and rises in interest rates decrease the quality of the borrower whereas credit rationing prevent viable projects from being funded. With credit rationing, supply cannot meet demand, as banks are, in effect, reducing their risk by lending to viable businesses. 'Stepped and peer lending' is regarded as another viable alternative for increasing the availability of loans to small establishments (BOE, 2000; Rogaly *et al.* 1999:113). Stepped lending is where a relatively small loan is sanctioned and on repayment the borrower has shown that they can be bankable and can borrow a larger sum of money. Peer lending is where small numbers of borrowers come together to personally guarantee each others loans, thereby minimising the risk of one person defaulting on the loan.

Finance Gap

Although it is commonly believed that a finance gap exists, research by Cressy (2002) questions whether a funding gap exists and if so, what should be done? Cressy (2002:F2) defines the funding gap as either 'positive' or 'normative'. A positive funding gap occurs when the level of lending is lower than demand (i.e. credit rationing), whereas a normative funding gap is defined by 'market failure, [whereby] the appropriate policy response to which is an increase in the volume of lending' (i.e. Government subsidies) (Cressy, 2002:F2). The majority of lending by mainstream financial institutions is assessed on quantitative information and, as such, is purely '*transactions-based*' (Cressy, 2002). However, more time consuming and therefore more costly, qualitative assessments are used to supplement quantitative evaluations when information asymmetries occur (Cressy, 2002). Cressy (2002) suggests that such ‘arms-length relationships’ only occurs with less established enterprises that cannot produce evidence of their business activities. Uzzi (1999; Uzzi and Gillespie, 2002; Uzzi and Lancaster, 2003) disagrees with this statement and indicates that it is only when businesses build a network of close and arms-length ties with banks over time that they then gain from their banking relationship. In this way, Uzzi suggests that only existing businesses that have been able to develop the relationship with the bank will access favourable rates of finance. The literature suggests that start-up businesses are further prevented from accessing finance because they are likely to have information asymmetries and lack the close relationship with their bank.

The Small Firm Loan Guarantee Scheme (SFLGS)

The *Small Firm Loan Guarantee Scheme* (SFLGS) was introduced by the UK Government in 1981 and was designed to widen access to finance for small firms. The SFLGS provides a 75% guarantee for bank loans to viable small businesses that cannot provide security (Deloitte and Touche, 2002; DTI, 2003). Eligible businesses must be five years old or less. All loans are from £5,000 to £250,000 for repayment over two to ten years. There are twenty-two authorized lenders of the SFLGS which include the five major banks operating within the UK. This enables SMEs to find the best deal. In 2003/2004 almost 6,000 loans worth £400 million were made under the SFLGS (Graham, 2004). Default rates of the SFLGS average between 30-35% (Graham, 2004).

The high default rate could explain why banks are still reluctant to administer loans under this scheme. The key finding of the *Graham review*[10] (2004) was that many small firms do not face barriers in accessing finance, yet for some there is a significant debt gap in the UK market as a result of SME owners' lack of collateral (Graham, 2004). Providers of the SFLGS have under-performed in taking up the SFLGS and rarely market the SFLGS. Many small firms, therefore, are not aware of the scheme (Deloitte and Touche, 2002). The reorientation of Government policy to support small firms through banking changes and enterprise policy highlights the significance of small firms in the economy.

Equity Finance: Venture Capital and Business Angels

The availability of venture capital[11] has been hotly debated by academics in recent years, on the assumption that for the development of the 'entrepreneurial economy' venture capital is essential (Mason and Harrison, 2002:427). Much of the research has ignored the role of venture capital in redeveloping local economies, and has instead focused on the growth of the sector and investment practices from a management perspective (Mason and Harrison, 2002). Equity can play a 'catalytic role … in the entrepreneurial process by providing finance' to businesses that wish to grow (Mason and Harrison, 2002:430). There are three forms of equity finance available for small firms; personal/informal equity (from friends and family), venture capital and business angel investment.

---

[10] The Graham review (2004) was commissioned to assess the effectiveness of the SFLGS in facilitating access to finance for SMEs.

[11] Venture capital is defined as: 'The provision of finance by professional investors to businesses that are not quoted on a stock market and which have the potential to grow rapidly and become significant businesses in international markets.' (Mason and Harrison, 1999:159).

Mason and Harrison (2002) believe that there is an uneven distribution of business angel and venture capital activity across the UK. This is a result of 'spatial variations in entrepreneurial activity' (Mason and Harrison, 2002:432). There is an uneven spatial distribution of venture capital across the UK as investments favour 'economically buoyant geographical locations' (Mason and Harrison, 2002:432). Mason and Harrison (2002) suggest that equity investment is a demand and supply issue. So where demand is greatest, as in the South East of the UK, equity is supplied. In addition, the South East has the appropriate infrastructure (e.g. law firms, accountants), and long term viability compared to other UK regions where the demand may not exist as firms are not investment ready. As such, the availability of equity has 'considerable significance in shaping the pattern of regional economic development' (Mason and Harrison, 2002:444). Many of the investment issues faced by venture capital and business angels are similar to mainstream financial institutions. These are adverse selection, information asymmetries and moral hazard.

In the UK, it has been suggested that there are insufficient numbers of small firms that are investment ready for business angels and venture capital seeking investment opportunities (Mason and Harrison, 2001, 2002). Martin (1999:181) argues that the establishment of formal business angel networks are more efficient in preparing investors with their requirements and matching investors with small firms who are investment ready. Nevertheless, the informal investment market is possibly the main resource of equity finance (Mason and Harrison, 1997). Yet significantly, this informal market relies on the information supplied through a network of family, friends and associations to link investors and capital. Thus, formal and informal networks play a key role in funding investment opportunities.

Enterprise Best Practice

Enterprise best practice is characterized by flexibility, benchmarking, lean production, strategic alliances and innovation (Schoenberger, 1997). Strategic alliances have become increasingly significant for businesses. Schoenberger (1997:47) states that ‘strategic alliances must be based on trust and open communication or nothing at all’ although she acknowledges that alliances are not without their problems and capitalism operates on the basis of exclusion and inclusion. In this way, networked firms can benefit from communication and co-operation as it can make them more competitive and open up new opportunities. Moreover, Schoenberger (1997:79) believes that time, space and competition are ‘intimately and profoundly bound up with a whole range of material practices, social relations, and understandings’ which, in turn, influence the corporate culture and strategy of the firm. Schoenberger (1997:212) adds that ‘in a capitalist society at least, firms must compete or die’. This is true for both for-profit and not-for-profit organizations in advanced capitalist societies. The rise of the professional within social enterprise management means that there has also been a need for social enterprises to mirror their commercial counterparts, especially in the case of benchmarking, and accountability. This has made the third sector become increasingly cost effective and efficient, with the assistance of staff, the board of directors and their supporters.

This section on mainstream finance has explored the supply of debt and equity finance to SMEs. It has highlighted the barriers to accessing finance due to credit scoring and lack of credit history, despite the established SFLGS which aims to bridge the finance gap. That said it is clear that gaps remain in the provision of finance for small firms and alternative measures have been made to counteract the balance in favour of firms that may not have a suitable credit record but do have viable business propositions. In many ways, strategic alliances and networks within which firms are embedded can help to satisfy their financial needs though this is dependent upon time and space. In sum, mainstream financial institutions favour lending to enterprises where the rewards are substantially greater than the risks.

Access to Finance: Alternative Economic Spaces

The principle of alternative economic spaces is founded on the understanding that the economy is socially constructed (Lee and Leyshon, 2003). The social economy[12] is one aspect of the alternative debate and moves between the market and the state thus placing the local community at its core (Leyshon and Lee, 2003). The social economy is perceived to be between the public and private spheres, forming an alternative space to the mainstream in which to regenerate deprived areas, which is part of the third way political agenda (Amin *et al*. 2003). Institutions within alternative economic spaces include; not-for-profits, social enterprises, co-operatives, charities, private limited companies, *Industrial and Provident Societies* (IPS) and credit unions (Amin *et al*. 2003). Like their for-profit counterparts, charities and social enterprises are difficult to define

[12] The social economy is comprised of social enterprises which are defined as businesses that operate with social and/or environmental mission giving them a double or even triple bottom line.

due to the diversity and complexity of the sector (Bryson *et al*. 2002). Yet the third sector, as the social economy is also known, is characterized by not-for-profit, independent enterprises and by their actions for example, education, poverty relief, religion and community services (Bryson *et al*. 2002; Burns *et al*. 2004; Leyshon *et al*. 2003). Amin *et al*. (1999) suggests that the social economy is not a radical form of alternative economy but a form of conservative or bourgeois socialism to moderate capitalisms impacts without replacing it. This section outlines what economic geographers mean by alternative economic spaces and the significance of alternative finance.

What are Alternative Economic Spaces?

Economic geography has only relatively recently taken an interest in alternative financial institutions and the spaces in which they operate (Fuller and Jonas, 2003; Lee, 1999). The interest in alternative economic spaces stems from the withdrawal of mainstream retail financial institutions from deprived areas, creating markets that are unserved and/or underserved by the mainstream banking sector (Leyshon and Thrift, 1996, 1997). Moreover, alternative economic spaces are those that local communities can occupy to gain financial independence (Lee, 1999). Economic geography has attempted to identify alternative locally based economies in contrast to neo-liberal global capitalism (Fuller and Jonas, 2003:55). The operations of alternative enterprise are supposed to differ to those of public and private enterprises. Amin *et al*. (1999:2036, original emphasis) assert that:

> ‘the social economy provides a means of *empowering* excluded groups and thereby *democratizing* regeneration activity. The second claim, often expressed in the broader language of *economic sustainability*, is that the experience of entrepreneurship and public-private partnerships can allow social economy organizations to become *self-financing* in the long term and therefore independent of the state. Third, it is claimed by critics of the mainstream economy that the social economy has the potential of being more than an *intermediary stage* between social exclusion and participation in the formal economy, to constitute a permanent, radically different, *alternative*.’

There is a danger, however, in assuming that all non-mainstream economic institutions are alternative. Like their mainstream counterparts, they have to survive whether this is through the reliance on public (or less often, privately) generated funds and are motivated by a double bottom line. It is likely that social enterprises will rely on public subsidies to survive unless it is matched by private investment, therefore with a balanced portfolio of public and private funds and social enterprises can then aim to become sustainable (Amin *et al*. 2003). Many social enterprises rely on short term public funds to operate and there is little incentive to do otherwise (Amin *et al*. 2003). Even if social enterprises do flourish there is no guarantee that their operational model will work elsewhere or that they can expand into other markets (Amin *et al*. 1999). On this basis, ‘the long term role of the social economy with regard to the mainstream is ambiguous’ (Amin *et al*. 1999:2046), especially without commitment and trust from ‘social entrepreneurs and intermediaries’ (Amin *et al*. 1999:2048). In addition, alternative economic spaces rely on mainstream practices for them to operate. In this way, alternative economic spaces may be seen as complementary to the mainstream rather than truly alternative.

Social enterprises have been promoted by the current UK Labour Government as a way of filling the gap left by the retreat of the welfare state. If the Government has aided the development of social enterprises and these enterprises rely on Government, local authorities and banks for funding and support, for example, they are not isolated from the wider economy or society. As such, it could be argued that alternative economic spaces are not truly alternative. One objective of this thesis is to explore the tensions between alternative and mainstream debates through the example of Community Development Finance Institutions (CDFIs) which are perceived to be alternative in that they offer an alternative source of finance for enterprises that are financially excluded but have a viable business proposition.

Uneven Geographies of Alternative Economies

For social enterprises 'geography matters' (Bryson *et al*. 2002) as the local geographies that they occupy exclude and include certain sections of the community. Owing to 'the geography of … charity [being] closely related to the historical and localized accumulation of capital', charities were founded by wealthy philanthropists. The location of such philanthropy 'mirrors former geographies of private wealth' (Bryson *et al*. 2002:52). In this way, 'charity may effectively exclude those most in need' (Bryson *et al*. 2002:55). It is important for social enterprise to become embedded within local social networks as the recipients are local (Bryson *et al*. 2002). Fundamentally:

> 'the problem is that the uneven geographies of the third sector implies that access to the sector's services and support is more about location and background than real need' (Bryson *et al*. 2002:57).

On this basis it may be suggested that there is uneven development within the third sector and there is a divergence between those that support the third sector and those that receive support from the third sector. The debates surrounding alternative economies are significant in that they highlight access to finance at a local level to those who are marginalized from mainstream services. Alternative economies may simply strengthen uneven development and the spaces between those who are financially excluded (Amin *et al*. 1999).

Social enterprises rely on public funding, which constrains their ability to procure assets and determine long term strategies (Amin *et al*. 2003). The fragmentation of the welfare state has led to social enterprises creating opportunities within the gaps left behind by the retreat of the state (Amin *et al*. 2003). Amin *et al*. (2003) suggest that some staff employed by social enterprises are driven by a personal commitment to altruism rather than salaries, as these tend to be lower than the mainstream sector. Yet, the rise of the social enterprise has led to 'a class of [mobile] social economy professionals' that are detached from the particular place that they are working within (Amin *et al*. 2003:47). This assertion by Amin *et al*. (2003) is contradictory and is perhaps, an over generalization as some prefer to work within the not-for-profit sector and are interested in salary. There is a tension between salary and professionalisation. Many of the senior posts within the social economy are held by professionals, perhaps because of their expertise and skill deficits within local areas (Amin *et al*. 2003). Amin *et al*. (2003) warn that as the social economy becomes increasingly professional in its approach to regeneration:

> 'there is a danger that it will become increasingly bureaucratized and standardized [into] a 'one-size-fits-all' solution applied to 'communities' and 'neighbourhoods' by 'experts''

In this way, the nature of the alternative social economy could become contradictory as it might function to enhance uneven access when its purpose is to reduce various forms of social and financial exclusion and to address local needs.

This section has explored the contradictory nature of alternative economies with particular reference to the social economy. The definition of what an alternative economy is, its uneven development and access to services and operational conflict within it demonstrate the need for further research in this area. The next section goes on to discuss CDFIs and how they fit within the mainstream and alternative access to finance and operational practices to develop the argument within these debates.

How do CDFIs fit into the literature?

CDFIs offer finance for enterprise (for-profit and not-for-profit businesses) and operate on a not-for-profit basis with a double bottom line in deprived areas of the US and UK. It has been argued that CDFIs are an alternative vehicle providing for enterprise as they operate as a lender of last resort. It could be argued that they are complementary to the mainstream as they are financing enterprises and helping them become part of the mainstream system over time. In light of this, this thesis attempts to understand how CDFIs provide access to finance and how they bridge the gap between fulfilling social objectives and economic purposes.

SMEs remain at the forefront of economic policy as they are seen to support high economic growth, and promote economic stability (BOE, 2004; NSFNR, 1999). This states the case for ensuring small firms continue to receive support and do not face barriers to finance, especially those small enterprises in disadvantaged areas that could benefit the greatest from such an economic boost which could reduce poverty, stimulate jobs and regenerate local economies, which would empower people in the process (BOE, 2000; NSFNR, 1999). Yet:

> 'The distribution of enterprise could be spatially uneven, and that policies to promote enterprise could be spatially regressive in the sense that the prosperous areas would benefit more than the less prosperous' (Acs and Storey, 2004:871).

This suggests that those entrepreneurs whether they are located in disadvantaged areas or not, may benefit from enterprise policies and business support. The Bank of England's

(2000:v) report on ‘Finance for Small Businesses in Deprived Communities’ asserted that a number of elements contribute to banks increased risk and hence reluctance in lending to ‘marginal and near bankable businesses’ in disadvantaged areas despite Government efforts to create opportunities for all. The factors which make banks less likely to lend to enterprises in deprived areas include information asymmetries:

> ‘Lack of business experience; lack of collateral and personal equity; concentration in business sectors subject to higher failure rates; remoteness; small and localised markets; and high crime rates’.

The *Government’s Policy Action Team 3* (PAT 3), a subsidiary of the *Social Exclusion Unit*, produced a report on ‘*Enterprise and Social Exclusion*’ (NSFNR, 1999) which endeavoured to discover how to stimulate business enterprise and, principally, sustainable enterprise in the deprived areas of the UK (NSFNR, 1999). The key elements of the PAT 3 strategy were; first, to provide better access to services and increase awareness of support facilities; secondly, to remove barriers to enterprise and finance; and thirdly, to create more effective institutions to assist enterprise start-up and development by adopting a coordinated approach from voluntary, public and private services, at a national and local scale (NSFNR, 1999). Also, it required mainstream financial institutions to understand the barriers to finance for small enterprises in disadvantaged areas through supporting corporate social responsibility (CSR) strategies (McGeehan *et al*. 2003). Furthermore, the key finding of the report was that SMEs in disadvantaged areas faced considerable barriers when accessing finance for those firms wishing to start-up or develop their businesses. With Government backing, CDFIs were promoted as lenders of last resort, with the aim of bridging the funding gap being experienced by SMEs in areas of high deprivation. CDFIs are sustainable, independent finance institutions that provide capital and support to empower individuals or organizations to develop opportunity and wealth in disadvantaged areas. CDFIs can provide relatively small loans from between £1000 to £80,000 and advice to small businesses and for personal finance. They concentrate on finance for enterprise, both for-profit and not-for-profit SMEs. The Government set out the case for CDFIs in that loans not grants were seen as an alternative to giving those living and working in deprived areas a hand up not a hand out under the support of the *Small Business Service* (SBS)[13] which is responsible for the Phoenix Fund (which was established in response to the PAT 3 report in 1999). The Phoenix Fund supported CDFIs amongst others by providing them with revenue, capital and loan guarantee support in order to deliver loans to businesses in deprived areas.

CDFI Lending Process

As CDFIs are social financial institutions, their lending process is assessed on both social and economic criteria (NFSNR, 1999). For instance, the application is assessed on the viability of the business proposal, whether the client has been refused finance from mainstream institutions, if they are creating or preserving jobs, if they are providing new opportunities for the community and if it would be an ethically and environmentally sound investment (Bryson and Buttle, 2005). The key criteria of CDFI lending, as in bank lending (BOE, 2000), is the viability of the business proposal, essentially the ability to repay the loan. CDFIs do not necessarily require security for the loan, as those in deprived areas are less likely to own their own home. Nor do they require a good credit

[13] The SBS was part of the UK's defunct Department of Trade and Industry (DTI) and is now known as the Enterprise Directorate under the new Department of Enterprise, Business and Regulatory Reform (BERR).

history, as some may not even hold a personal bank account. From this it could be suggested that CDFIs adopt a venture capitalist approach to lending, in that they try to employ due diligence to reduce information asymmetries and adverse selection (Mayo *et al*. 1998). Thus this method reduces 'surprise' rather than 'risk' as CDFIs are bridging the finance gap for businesses that mainstream lenders would not approve without security and/or a viable credit history.

According to NEF and Nicholson (2003:22) banks view the small business market as 'profitable and competitive'. However, banks are reluctant to sanction loans to businesses that do not have collateral, a track record, a viable business proposal or operate in high risk sectors such as retail or catering and are not investment ready. This disproportionately disadvantages SMEs at start-up. CDFIs assess a loan application on the viability of the business proposal and the character of the borrower, taking a traditional relationship banking approach. Also, CDFIs may provide business support alongside financial support to strengthen the chances of their client succeeding. It is estimated that CDFIs 'meet only 10% of the potential demand in the small business market' due to the nature of the different CDFI operations and uneven coverage across each UK region (NEF and Nicholson, 2003:29). In addition, this could be due to the market being difficult to access and may also be very small so the demand may not be as great as anticipated. One of the aims of the thesis is to explore the nature and operations of CDFIs to determine the scale and impact of their activities by defining how CDFIs in the UK and US identify and measure the effectiveness of the socio-economic criteria that drives their business models. This will also help to identify best practice and to develop and inform other UK CDFIs.

CDFIs: Alternative or Mainstream Financial Institutions?

CDFIs are viewed as alternative institutions as they are providing financial products and services for the financially excluded (Leyshon and Thrift, 1994). Mainstream financial institutions are increasingly risk averse and this means that potential customers that are located in geographically deprived areas are increasingly likely to be refused credit (Leyshon and Thrift, 1994). Leyshon and Thrift (1995) state that financial institutions need to be locally embedded in order to understand the needs of borrowers. Fuller and Jonas' (2002) work on credit unions imply that they offer alternative sources of finance. Credit unions offer savings and loan facilities to members that are united by a common bond such as a community-bond or employee-bond. Credit unions are regulated by the Financial Services Authority, and offer savings and loans much in the same way as mainstream banks. However, credit unions operate differently to the mainstream providers in that they are restricted geographically and offer only personal financial products and services to the specific markets they serve. Thus, it could be argued that credit unions offer complementary services to that of the mainstream as they offer financial services to those who are excluded from mainstream financial institutions and do not compete with mainstream providers. Collectively, the geographies of finance literature focuses on personal financial products and services such as LETS and credit unions, ignoring alternatives to the mainstream providers of finance.

Buttle (2005:18) aimed to 'understand the diverse complexities, economic and ethical subjectivities, networks and discourses which shape the emerging social finance sector' using an ethnographic approach. He explored the UK social finance sector, in particular, *Charity Bank* and how it was established, funding the activities of making loans to social enterprises and the impact of receiving loans on social enterprises. As such, Buttle focused on financially excluded social enterprises rather than commercial enterprises that could not access finance. The key findings of Buttle's thesis in relation to social finance organizations were that they are complex organizations that operate using a 'socio-financial narrative'. In doing so, they are described as hybrid organizations that could also be described as schizophrenic. This PhD differs in that it explores the complexity within US and UK CDFIs as a mechanism for providing finance for near-bankable enterprises. The case study approach also allowed 'embedded…complex network[s] of internal and external relationships' to be identified and disentangled (Schoenberger, 1991:181).

Thesis Aims

The literature review has explored mainstream and alternative finance to highlight the gaps in the financial geographies literature. This literature has focused on mainstream financial providers. In particular, retail bank activity and personal financial exclusion. Financial geographies have also explored the notion of alternative economic spaces such as credit unions and LETS (Leyshon *et al*. 2003). Again, these issues relate to personal finance, rather than access to finance for enterprise despite the significance of financial exclusion within economic geography. The literature review has also considered CDFIs as potential alternative financial providers. This research seeks to uncover a more nuanced account of alternative finance given the diversity of the system and mainstream finance as other arguments are too simplistic. The role of CDFIs is to create bankable businesses, which is also about mainstreaming enterprise. Existing US and UK research on CDFIs is limited and there are no comparative studies on the US and UK CDFI sectors. Also, much of the research on CDFIs is literature based (Marshall, 2004), thus there clearly is an opportunity for empirical work on US and UK CDFIs. The context and role of CDFIs will be explored to reflect the complexity surrounding CDFIs in being able to define their activity and where they fit within the mainstream and alternative literatures. Bryson and Buttle (2005:278) have argued:

> 'that trying to identify what produces complexity should be the central focus of the analysis of 'alternative' financial institutions. Central to this task is an understanding of the motivations and strategies that lie behind different ways of performing or practicing business activities'.

This call to understand the complex nature of operations of alternative financial institutions will be realized in this thesis through exploring how and why US and UK CDFIs operate, what are the drivers and the issues surrounding their activity.

Conclusions

SMEs are vital to the US and UK economies and some small businesses are disproportionately disadvantaged as a consequence of the existence of a finance gap and uneven access to finance. Small firms are perceived to be effective as they are geographically dispersed, can respond to local demand, and become embedded in local networks and local culture. However, it is clear that small firms face challenges when accessing finance as a result of persisting market inefficiencies. Thus, access to finance for enterprise needs further detailed research.

This chapter has discussed small firm access to finance in relation to the terms and conditions associated with accessing mainstream debt and equity finance and the geographical restrictions that exist in accessing finance. The chapter has illustrated how SMEs can be excluded from obtaining mainstream finance despite the introduction of the SFLGS, the development of venture capital and business angel finance. Alternative economic spaces were explored to highlight where CDFIs are situated within the social economy. The next chapter will explore the methods used to undertake the research, while chapter 4 examines the nature and operations of the CDFI sector in the US and UK. The key question to be addressed is: do financial institutions like CDFIs offer a solution to the market gap that exists for SMEs seeking finance?

CHAPTER 3 METHODOLOGY

This chapter explores the research design and the methods used to investigate if and how CDFIs in the US and UK are tackling financial exclusion whilst balancing their financial and social objectives. The research began in October 2004 with the empirical work undertaken between October 2005 and September 2006. The empirical work included a mix of qualitative interviews with UK banks, six US and five UK CDFIs, the US and UK CDFI trade associations the *Opportunity Finance Network* (OFN) and *Community Development Finance Association* (CDFA), a number of active clients of one UK CDFI, and quantitative analysis of one UK CDFI's risk profile.

The first part of this chapter outlines the background of this research. The second part explores the qualitative empirical research by exploring the issues and constraints surrounding accessing the US and UK CDFIs, and ethics and positionality. The third part of the chapter explores the quantitative empirical research.

The CASE Studentship

This *Economic and Social Research Council* (ESRC)/Collaborative Awards in Science and Engineering (CASE) funded research studentship was initiated by Professor John Bryson and ART, a CDFI based in Aston, Birmingham, UK. ART wanted to fund a PhD as it had previously worked with a Masters student and saw the potential for further research within academia. Some of the ART board members felt that if the CDFA were not going to produce the work necessary to inform ART and the wider CDFI sector (including *Regional Development Agencies* (RDAs)) of the issues and challenges, then it would initiate some research on the sector itself. In addition, the measurement of social impact was a key issue for UK CDFIs at the time. This PhD reflects the complexity surrounding issues facing the CDFI sector at this time, especially measuring social and financial impact given the diversity of UK (and US) CDFIs. Bell and Read (1998:7) state that:

> 'CASE studentships essentially involve non-academic organizations and academic departments in the support of doctoral students researching topics of mutual interest'.

The benefits of a CASE studentship include the opportunity to develop skills, work collaboratively, provide independent expertise, gain real life experience outside of academia and do research that the organization is unable to do internally (ESRC, 2007a). ART is the UK's leading CDFI. ART is an IPS which uses social investment as a means of raising funds. ART was established in Aston, Birmingham, UK in 1997 and uses a pioneering model of finance, as it lends to businesses with a social and economic purpose, therefore contributing to regeneration by providing jobs and empowering the socially excluded and economically deprived in Birmingham. ART provides loans at commercial rates to viable SMEs and social enterprises that are unable to access finance from mainstream financial institutions. ART evaluates the viability of each loan application individually to assess how the loan will impact upon creating and retaining local jobs whilst keeping ART financially sustainable. Therefore, ART has the contentious issue of balancing social and financial objectives, which can itself exclude potential clients borrowing from ART. ART needs to be locally and nationally embedded in the financial and business support networks that sustain economic activity in the West Midlands, as it is through these activities that ART identifies both potential loan borrowers and loan capital. These two constraints (and contradictions) resonate with on going academic debates concerning alternative economic spaces (Amin *et al*. 1999, 2003; Bryson and Buttle, 2005; Buttle, 2005; Fuller and Jonas, 2002, 2003; Lee, 1999; Leyshon and Thrift, 1994, 1995, 1996, 1997, 1999; Leyshon *et al*. 2003; Martin, 1999; Purcell and Cobb, 2004; Williams *et al*. 2003), the role and geography of social enterprises (Bryson *et al*. 2002) and the embeddedness of economic activities (Taylor, 1999; Taylor and Asheim, 2001). ART's role is twofold. First, it provides loans to financially excluded SMEs. Secondly, it plays a national role as it contributes to regional and national SME policy on enterprise. CDFIs are inherently geographical as they are about people and places. The people are financially excluded and the places are disadvantaged.

Ethics

The ESRC Ethics framework aims to encourage best practice within social science research. As such, the ESRC has set 6 key principles which are;

- Research should be designed, reviewed and undertaken to ensure integrity and quality
- Research staff and subjects should be informed fully about the purpose, methods and intended possible uses of the research, what their participation in the research entails and what risks, if any, are involved.
- The confidentiality of information supplied by research subjects and the anonymity of respondents must be respected.

- Research participants must participate in a voluntary way.
- Harm to research participants must be avoided.
- The independence of research must be clear, and any conflicts of interest or partiality must be explicit (ESRC, 2006).

These guidelines identify the significance of reflection, which is an essential part of research so that the researcher can identify strengths and weaknesses within the process. Informed consent and anonymity was granted by all participants therefore all the case studies, their employees, office locations and participants within this research, with the exception of ART, are anonymous. This is to ensure confidentiality of the research.

Perhaps one of the most important ethical issues regarding my research is the fact that it is a CASE studentship. It is unusual for a social enterprise with limited funding, like ART, to decide to fund a PhD. However, by undertaking a CASE studentship, ART has

- ‘The opportunity to access key expertise that may not exist within the company or which may not be cost effective to develop in-house.
- An opportunity to test the value of collaborative research for a relatively modest outlay
- The ability to fund valuable but not necessarily the highest priority research, for which an economic case for doing the work in house would be difficult.
- Providing future researchers/potential employees with ‘real life’ experience of situations outside academia whereby academics have a

better understanding of the public/voluntary sector and employees have improved research skills.

- Developing the skills and careers of staff' (ESRC, 2007b:1).

The CASE has enabled a unique opportunity to work with an innovative alternative finance institution in the UK. The role of ART was to facilitate access to the CDFI sector in return for three annual reports. The first year report outlined the preliminary findings from the US and was also presented to the board of directors. The second report provided a discussion on sustainability for the board of directors. The third and final report will summarize the key findings of the PhD. The final report will be based on chapter 8 of the thesis. On the positive side the CASE studentship has provided a unique opportunity to access data that would not normally be readily available. ART has also facilitated access to key networks, for example other CDFIs, CDFA, OFN, SBS and mainstream banks. I have three supervisors Professor John Bryson and Professor Mike Taylor at the University of Birmingham and the Chief Executive of ART. Drawing upon a number of experts can be advantageous as they have a wealth of 'knowledge and experience' (Bridges, 2006:17). There have been a series of meetings with all three supervisors at ART offices to discuss progress and the next stages of the research. Also, I have had a number of low key meetings with Steve Walker to learn about ART and the UK CDFI sector. ART have been selective in what they have told me and what I have had access to, for example, I have not attended their lending committee meetings and have only been privy to what they have told me. In the research process, it is important to remember that what people do not say is often as important as what they do say. Steve

Walker has read the final draft of the thesis to see if the ART information in chapter 7 has been placed correctly.

Policy relevance is a key issue for empirical research particularly within geography. James *et al.* (2004:1904) have called for 'PhD students to explore critical policy issues and engage in the construction and/or critique of public policy'. The research is policy relevant as CDFIs were designed to be a policy tool for the current Government, I consider that the academic context also holds great significance because of the lack of research in this area. Although there is a distinction between policy relevant research rather than policy driven research (James *et al*. 2004). Policy relevant research indicates that research is independent and has implications for policy, whereas policy driven research is potentially outdated by the time it is published as policy moves on. The shifting nature of policy indicates that there is a need to broaden the research significance. In the case of this research on CDFIs, the same debates could be explored by other social enterprises, Government policies and small firms in that historically, valuable projects are dominated by short-term funding creating further uneven development and access to services. In addition, the debates raised here are valid for all SMEs (for profit and not-for-profit), academics, independent research agencies and policy at a local and national scale across the US, UK and Europe.

Positionality

The positionality of the researcher has been carefully established so that minimal effect has been made on the research itself. However, the research gathered via interview may reflect one particular persons thoughts at a particular time which makes research space and time specific. It is hoped that the research is been without bias as far as possible, although being linked to the CASE partner may or may not have its own implications. It was important as a researcher to remain as neutral as possible yet understandably, positionality plays an important part in the interview process and analysis. Although it must be noted that reflexivity and positionality impacts upon the research and its conclusions. The key ethical issue of this research aside from my own issues is the question of who benefits? It is hoped that this research goes some way towards helping the financially excluded access finance through influencing CDFI operations, mainstream banks, supporters of the social finance sector and policy.

The PhD rationale was set out by Professor Bryson in consultation with ART for the ESRC application. Using the ESRC application as a framework, it was my role to develop and apply this information to shape and produce the research. The original research questions were as follows:

1. To explore the processes by which CDFIs become embedded in local financial and business support networks.
2. To identify and analyze the ways in which CDFIs in the UK and US construct and measure effectiveness of the socio-financial narratives and criteria that drive their business activities.

3. To explore the financial costs and means of overcoming them of socio-financial narratives that emphasis social benefits before CDFI profitability.
4. To benchmark ARTs activities and practices against other CDFIs in the UK and USA and to identify practice that can inform the further development of CDFIs in the UK.

As the research progressed, it was evident that there has been less emphasis on some objectives than originally envisaged. For example, the concept of embeddedness was thought to be a key issue in the investigation largely owing to the changes within the CDFI funding environment. At the start of the PhD, the support for the UK CDFI sector in particular was undergoing a significant policy shift which meant that the original research proposal had to change. This highlights that the research process is constantly moving according to the environment in which the research takes place. By developing the research objectives (as outlined in chapter 1) I took ownership of the research by recognizing that the US and UK CDFI sectors were evolving. The alterations to the research aims were driven by the need to understand how and why the issues that the sector faced were changing. These aims helped to structure and develop the methodology to establish how the aims could be applied in certain settings, for example, the interview questions. The research objectives may have changed during the research but the PhD title has not because the focus and overall aim has remained the same, to explore if and how CDFIs overcome financial exclusion.

Timetable of Research

The first year was spent reading, the second year undertaking research and the third year, writing up. On starting the PhD it was evident that the research process was more of an iterative process of reading, writing and research to maintain skills and to develop new ideas. Similarly, the research timetable outlined below indicates the order that each phase began but it was a continuous process rather than linear (Figure 3.1).

Figure 3.1: Timetable of Research Methodology

Phase 1: Literature Review

Phase 2: Interviews with Key Actors

Phase 3: Attendance at CDFI Conference

Phase 4: Interviews with UK Mainstream Bank

Phase 5: Interviews US

Phase 6: Interviews UK

Phase 7: Interviews UK CDFI Clients

Phase 8: Quantitative Analysis of ART data

Each phase of research developed my knowledge and understanding which also raised questions for the next phase. Phase 1 was an introductory phase, beginning with the key literatures surrounding enterprise, access to finance and community development. This gave me a background to the research and knowledge of the key issues which allowed me to begin phase 2 and interview key actors at ART (chief executive, board members and loan officers) and in the CDFI sector. Phase 3 was a key phase of research as this involved attending a number of conferences specifically designed for the UK CDFI sector. This not only allowed for up-to-date issues to be recognized but they were also a key networking opportunity to recruit potential candidates for the pilot interview and case studies. This phase was repeated a further two times when the CDFI trade association held its annual conference. From the third phase I undertook a number of interviews at a mainstream bank (phase 4) and make informed questions. Learning banking background knowledge and terminology played an essential part in being able to do this. Phase 5 involved undertaking two research trips to the US to explore 6 CDFIs within two locations in addition to the US CDFI trade association. Phase 6 of the research process entailed undertaking research at 5 UK CDFI case studies. The next part, phase 7 is when the UK CDFI data had been completed and a questionnaire of 8 clients of one UK CDFI could be undertaken. The final phase involved creating the data set and analyzing the ART risk profile data.

Qualitative Empirical Research: US and UK Case Studies

Initial research was made into the history and development of the CDFI sector in the US and UK whilst undertaking a literature review on CDFIs, social finance, social and financial exclusion, small firms, social enterprises, access to finance, performance and benchmarking, networks, mainstream financial systems and alternative financial spaces. Early research at ART involved reading through their library and observation of the lending process. This allowed the research to compare the lending process at a bank locally that operates at a global scale. At the bank, two interviews were undertaken; the area manager and a local business manager of the small business lending team. These individuals outlined their role, explained the referral and loan process, including their lending criteria, highlighted the risks involved in lending, default procedures, and the sectors that they operated within. The loan officers at ART were all former bankers and during their interviews, I was able to identify the differences between the bank and the CDFI loan process. There were stark comparisons between the CDFI and the bank lending process namely the lack of social criteria in a UK mainstream bank and the use of credit scoring to assess the lending risk.

Identification of Case Studies

The US and UK case studies were identified through collating information from the OFN and CDFA websites (Appendix 3.1). This involved searching the directory of UK CDFIs and creating a spreadsheet of data so that information could be gathered on each CDFI operating in the UK before identifying the key case studies using the criteria of sources of funds, target groups and markets served. The data collated for each CDFI included whether it was a revolving loan fund, which sector it served, key contacts, its history and development, the year it was established, whether any support is administered alongside the loan, and the sources of funding. This information was gathered via the CDFIs websites and through requesting information from the CDFI itself, for example their annual reports and promotional literatures. However, in the case of the US CDFIs, an internet search was all that time would allow. The US case studies were similarly identified although this was limited to two major urban geographical areas in the US. However, these areas cannot be disclosed due to the anonymity required by the case studies. Comparative case studies were identified by best practice, they had to provide finance for enterprise and had been awarded funding from the US CDFI Fund or UK

Phoenix Fund. This research only investigated revolving loan funds, although credit unions are classified as a type of CDFI and can also offer finance for enterprise in the US.

A matrix of UK CDFIs was developed that enabled the identification of potential case studies using the key criteria of whether the CDFI offered business development loan fund and social enterprise loan fund (Figure 3.2). These criteria were selected to closely reflect the operations of ART that serve these markets. If in the future the opportunity arose, the matrix can be replicated over time to identify change, if any, that had taken place within the CDFI sector. Also, the same could be done with the percentage of lending to add complexity to show what proportion of the market has the greatest/least demand and to highlight to what degree the market has shifted.

Figure 3.2: Headings Used in the Matrix of US and UK CDFIs

CDFI

Internet address

Year established

Geographical area

Tel no

Address

Contact

Loan type

Lending criteria

CITC accredited (UK only)

Phoenix Funded/recipient of CDFI Fund

Notes

(Source: Own research)

Access: UK CDFIs

The CASE studentship facilitated access to the CDFI sector, which could have been difficult to access without the CASE studentship. ART has acted as a gate opener to CDFIs in the US and UK. Through ART, access to contacts at the UK CDFI trade association, the CDFA, have been made and from this to the US CDFI trade association, the OFN (formerly known as the NCCA). Nevertheless, gaining access to the case studies remained a challenge despite introductions by the OFN and ART. Even when access was granted for the research, it was limited due to time, sensitivity of the CDFI sector and data protection. Also, within the banking sector there are issues over data that result from banking conventions that prevent the release of information to third parties. Originally it was envisaged that access to case studies would not be a problem due to ART's links with the UK CDFI trade association, the CDFA who would then open the door to US CDFI trade association, the OFN that could then act as gate opener to the US CDFI case studies.

In the UK, potential case studies were contacted by telephone initially by the Chief Executive of ART, Steve Walker and then a follow up by email. In the case of US CDFIs, this was sent via the OFN on my behalf. Potential UK and US case studies were sent a standard email to their Chief Executive (Appendix 3.2). Email was selected for speed and efficiency. Face-to-face contact with the OFN's chief executive Mark Pinsky was established at the CDFA's annual conference in 2005.

Unfortunately, access was denied by a number of US and UK CDFI due to resource constraints. The remainder of the case studies declined to give access to clients. At one UK CDFI case study, I was only able to interview the Chief Executive due to resource constraints. The restricted access that was experienced in the UK is indicative of the development stage of the industry and also that it is part of the financial sector. This is despite the fact that the age of UK CDFIs ranged from over 20 years old to less than 2 years in operation and the enterprises do not compete in the same markets or geographical areas. Also, due to funding changes that occurred during the research, CDFIs had to operate in an increasingly competitive environment especially in terms of accessing loan finance to lend on to clients.

Without doubt, key contacts have been crucial to accessing the case studies networks. The most important place in which to talk to UK CDFI practitioners and UK case studies has been the CDFA annual conference. The CDFA held its annual conferences in Melton Mowbray, Bristol and Ashford, Kent between 2005 and 2007. The CDFA represents the majority of UK CDFIs and their annual conference attracts policy makers, stakeholders and international CDFI practitioners. This UK conference has facilitated the US research as US practitioners have also attended this conference as keynote speakers. On this basis, people, time and space have also played a major role in this research.

Access: US CDFIs

Funding was awarded by the ESRC to carry out the research in the US. This money, along with school research funding allowed for two research trips to the US (one trip lasted two weeks and the other a week) over a 6 month time period, including attendance at the AAG annual conference in March 2006. The *National Community Capital Association* (NCCA) or OFN as it is now known, was helpful in assisting with the identification of case studies. US CDFIs were selected in the same way as UK CDFIs. An OFN staff member who was responsible for special projects was given the task of introducing me via email to potential case studies in the locations identified. On the whole, the US CDFI sector was open and welcoming. They were keen to share information and learn about their UK counterparts.

During Autumn 2005 empirical research was undertaken at four CDFIs located in rural and urban areas on the East coast of the USA as well as the national trade association for CDFIs, the OFN. The CDFIs that were investigated had revolving loan funds that offered finance to small businesses, as well as offering loans to other sectors and technical assistance. Each CDFI operated at a sub-regional or city scale although one CDFI operated in other states across the USA. The CDFIs that were examined were selected on the basis of location, markets served and best practice. The research identified four key themes: the operations (i.e. the loan process) networks, performance measurement and sustainability.

A key source of data on US CDFIs is the CDFI Data Project (CDP) which is compiled by the NCCA (Rubin with Zielenbach, 2006). However, the CDFI data project has limited scope due to a poor response rate. This is because the NCCA only has 160 members out of a possible 1000 US CDFIs. As a result of the large sector and time constraints, two regions were identified as potential case study areas. This allowed the identification of CDFIs that operated very similarly to that of ART. In the US, however, the loan funds are more diverse than in the UK which led to the research being undertake at CDFIs that sometimes dealt with a variety of markets which included lending to SMEs and social enterprises. In the US SME markets differ to those of the UK due to the classification of what constitutes a small enterprise in terms of number of employees and turnover, for example a US small business is one which employs less than 500 people compared to a UK small business is defines as employing 50 people or less (EC, 2007).

Pilot Studies

Two pilot studies were undertaken between Spring and Summer 2005. The first set of pilot studies were undertaken in Dublin whilst assisting a second year undergraduate field course with 4 key actors in the social finance sector in Ireland. The second pilot study was undertaken at Impetus, a CDFI in Malvern, UK which was a relatively new CDFI at that time. The case studies were selected for the pilot because of their location and timing. The success of these interviews determined the format for the rest of the research.

Interviews: US and UK CDFIs

Once access to a CDFI was agreed via the Chief Executive, recruitment of interviewees was not an issue. Prior to the interview, the interviewee was told how and why they were selected for the research and an outline of the research was given to each participant with contact details of my supervisors should they have any questions. The participant was asked if they gave consent to name them and their organization in my thesis or if they would like guaranteed anonymity (Figure 3.3). The organization was also informed that they would receive a summary of the research findings in return for their assistance. 57 formal interviews were carried out with a total of 6 US and 5 UK CDFIs, a UK high street bank, US and UK CDFI trade associations, key actors within the sector and 8 UK CDFI clients. Over 80 hours of data were recorded and transcribed, generating over 300 pages of transcript. By undertaking empirical work in the US and UK, this research explored a broad selection of CDFIs yet also obtained depth through a case study approach. By interviewing a number of people within the same organizations information can be checked and verified, thereby adding validity to the research. The case study approach also allowed 'embedded…complex network[s] of internal and external relationships' to be identified and disentangled (Schoenberger, 1991:181). This research differs to Buttle's (2005) thesis which in part, also explored ART, by taking a comparative approach to identify and understanding the complexity that exist within the operations and activities of US and UK CDFI.

Figure 3.3: List of Interviews

No.	Code	Location	Organization Type	Position	Interview Context	Interview Date
1	1a	US	CDFI	Loan Consultant	Loan Process	07.10.05
2	1b	US	CDFI	Loan Consultant	Private Equity	07.10.05
3	2a	US	CDFI	Director	Operations	11.10.05
4	2b	US	CDFI	Loan Consultant	Small Business	11.10.05
5	2c	US	CDFI	Associate	Research	11.10.05
6	2d	US	CDFI	Director	Energy	11.10.05
7	2e	US	CDFI	Director	Private Equity	11.10.05
8	2f	US	CDFI	Associate	Research	11.10.05
9	2g	US	CDFI	Director	Funding/Investment	11.10.05
10	2h	US	CDFI	Chief Executive	Operations	11.10.05
11	3a	US	CDFI	Chief Executive	Operations	13.10.05
12	4a	US	CDFI	Vice President	Investment/Operations	17.10.05
13	4b	US	CDFI	Vice President	Small Business	17.10.05
14	5a	US	Trade Association	Associate	Research	12.10.05
15	5b	US	Trade Association	Consultant	Business Support	12.10.05
16	5c	US	Trade Association	Associate	CDFI Sector	12.10.05
17	5d	US	Trade Association	Chief Executive	CDFI Sector	12.10.05
18	5e	US	Trade Association	Associate	Financial Support	12.10.05
19	6a	US	CDFI	Chief Executive	Operations	06.03.06
20	6b	US	CDFI	Loan Consultant	Loan Process	06.03.06
21	6c	US	CDFI	Technical Support	Technical Assistance	06.03.06
22	7a	US	CDFI	Vice President	Operations	07.03.06
23	8a	UK	CDFI	Chief Executive	Operations	13.01.06
24	8b	UK	CDFI	Loan Consultant	Loan Process	10.01.06
25	8c	UK	CDFI	Loan Consultant	Loan Process	10.01.06

26	8d	UK	CDFI	Director	Operations	13.01.06
27	8e	UK	CDFI	Director	Operations	19.01.06
28	8f	UK	CDFI	Director	CDFI Sector	20.01.06
29	8g	UK	CDFI	Director	Operations	07.02.06
30	8h	UK	CDFI	Director	CDFI Sector	05.06.06
31	9a	UK	CDFI	Loan Consultant	Loan Process	10.02.06
32	9b	UK	CDFI	Loan Consultant	Loan Process	10.02.06
33	9c	UK	CDFI	Chief Executive	Operations	10.02.06
34	9d	UK	CDFI	Client Liaison Officer	Debt Collection	10.02.06
35	9e	UK	CDFI	Director	Operations	10.02.06
36	10a	UK	CDFI	Chief Executive	Operations	03.05.06
37	11a	UK	CDFI	Chief Executive	Operations	21.06.06
38	12a	UK	CDFI	Chief Executive	Operations	21.06.06
39	12b	UK	CDFI	Loan Consultant	Loan Process	21.06.06
40	13a	UK	CDFI	Chief Executive	Operations	27.06.06
41	13b	UK	CDFI	Outreach/PR	Impact	27.06.06
42	13c	UK	CDFI	Director	Operations	27.06.06
43	13d	UK	CDFI	Director	Operations	27.06.06
44	13e	UK	CDFI	Director	Operations	27.06.06
45	13f	UK	CDFI	Loan Consultant	Loan Process	27.06.06
46	14a	UK	Bank	Loan Guarantee Unit	Small Firm Loan Guarantee	04.04.06
47	14b	UK	Bank	Loan Consultant	Loan Process	15.08.05
48	14c	UK	Bank	Loan Consultant	Loan Process	17.08.05
49	15a	UK	RDA	Consultant	Funding and CDFI Support	29.06.06
50	16a	UK	CDFI	Chief Executive	Operations	09.09.05
51	17a	UK	Small business owner	CDFI Client	Loan Process and Impact of Loan	04.07.06

52	17b	UK	Small business owner	CDFI Client	Loan Process and Impact of Loan	05.07.06
53	17c	UK	Small business owner	CDFI Client	Loan Process and Impact of Loan	06.07.06
54	17d	UK	Small business owner	CDFI Client	Loan Process and Impact of Loan	07.07.06
55	17e	UK	Small business owner	CDFI Client	Loan Process and Impact of Loan	19.07.06
56	17f	UK	Small business owner	CDFI Client	Loan Process and Impact of	19.07.06
57	17g	UK	Small business owner	CDFI Client	Loan Process and Impact	07.08.06

Interviews were undertaken with CDFI staff members and board of directors to access rich and quality information. It was important for the researcher to be well-informed about the organization and terminology prior to the interview as this minimized problems as I was able to use and understand technical banking terminology, such as moral hazard and risk (Schoenberger, 1991). In addition, there are many acronyms used to describe CDFIs, their activities and funding schemes within the US and UK CDFI sector, also in US the loan officers are known as consultants, which if I had not known this, could be misinterpreted. The same interview format was applied to all participants at each CDFI. This allowed for inconsistencies and complexity within an organization to be highlighted (Schoenberger, 1991). However, the most important questions depended on the interviewees role within the organization. For example, the questions for the Chief Executive were centred around their personal career history, the establishment and development of the organization, operations and strategy. Board members were asked about their personal career history, operational strategy, operations of the board and loan officers were interviewed about personal career history, the loan application and decision making processes, and the investment filter that were applied and linked to the CDFIs double bottom line. By personalizing the interview, communication with the interviewee can be developed (Quinn Patton, 2002).

Structured interviews whereby the same questions are asked for all interviews allowed the data to be comparable. Semi-structured interviews acted as a framework yet adds flexibility for the answers so that the interviewee could tell their story. By using a dialogue, it allows the interviewee to shape the research by covering issues that the researcher may not have considered but the researcher can keep the interview focused. A mix of open ended and closed questions as appropriate were used in order to access detailed information (Appendix 3.3). When questioning, asking ‘why?’ was used sparingly as it can make interviewees guarded as if they are being interrogated. Instead, probing questions were used to clarify, expand and/or explain what the interviewees had said such as ‘in what way’ (Quinn Patton, 2002).

Interviews have complex power relations that shift between interviewer and interviewee depending on who is speaking, what questions are asked, position (e.g. student/Chief Executive) conscious and unconscious bias, discrimination, difference of class and gender (Bennett, 2002). Smith (2006:652) calls for researchers to ‘consider that the power relations social scientists sometimes employ in relation to society at large do not necessarily translate directly into the interview space’. So for example, when interviewing regardless of who it is, whether it is staff at a financial institution or the chief executive of an organization, it is important to realize that the interviewee does not necessarily control the interview depending on the questions asked and approach to interviewing. In this research, it was important for the interviewee to be given a voice and to let them tell their story (Bennett, 2002) but the interviewer could steer the interview by using a semi-structured interview approach which could be followed depending on how the respondent answered.

A certain level of rapport was developed during each interview due to my knowledge of the CDFI sector. Some interviews were time limited which restricted the development of rapport and a certain level of trust. Conversely, whilst in the US, personal characteristics such as my English accent, perhaps helped me to build rapport with the interviewees. The location of interviews might have affected responses as interviewees selected the choice of venue. The CDFI staff were interviewed in a meeting room or office at their organization, apart from one US CDFI Chief Executive that I interviewed at a local café. Due to the nature of their role, the board of directors also chose their interview location. These were held at the CDFI offices, their own office, a cafe or in one case, involved a telephone call. Face-to-face interviews were preferred, but if not possible then telephone interviews were sufficient. The only issues really were when I arrived at an office and the secretary could not get hold of the person I was scheduled to see; in one case they had forgotten about the interview and then stated that they had expected to be sent the questions as that would have enabled them to prepare the answers. All interviews, including telephone interviews were recorded using a dictaphone. This made some interviewees conscious of what they were saying but on the whole, people did not mind being recorded.

However, by using a tape dictophone my interviews could then be transcribed by an audio typist which allowed me to analyze my findings and help me to aim to finish within three years. An independent audio typist was commissioned to transcribe the majority of interviews for accuracy, neutrality and to capture the entire interview, rather than select key issues to transcribe. On the same basis, the interviews were analyzed using Nvivo, a computer programme designed to organize, manage and analyze qualitative data. Nvivo allows the data to be coded so that ideas and themes can be linked.

Client Survey

It was believed that by interviewing only CDFI staff, the research would be unrepresentative. The voices of clients were considered to be just as important if not more so in that they have had experience of the products and services offered by CDFIs. In this way, a survey of CDFI active clients at one CDFI was undertaken. Active clients are defined as those borrowers that are currently repaying their loan. The only way that I was able to access clients was if they were selected by the CDFI. This element of the research is in no way representative of the CDFI but gives some indication of what the clients of CDFIs are like, their business and its needs. The interviews were undertaken via telephone to reduce time and cost. Many of the business owners worked alone and were often very busy, so numerous phone calls were made to see if they are able to undertake the interview at that time. This meant that even though the questionnaires only took between 10 and 20 minutes to complete, it took 8 weeks before I had gathered this data. The client questionnaire gave details of personal information, the loan, business, and their experience at the CDFI (Appendix 3.4). All clients were guaranteed anonymity.

Quantitative Empirical Research

The quantitative empirical research consisted of generating data based on ART's loan data to create a risk profile. The risk profile aimed to predict active loans that were most likely to default under the ART operational model. The 17 variables included individual characteristics such as gender, ethnicity, whether the borrower was employed prior to the loan, and whether the borrower had knowledge of the business or the sector.

Figure 3.3: ART Loan Data

- The nature of the borrowers business and loan.
- History of the loan (who introduced the borrower to ART).
- Performance of the loan (whether the loan was written off).
- Percentage lost at write off stage.
- The time frame from when the loan was sanctioned.
- If the loan was part of a larger finance package (with another lender or a multiple loan from ART).

A database was created using SPSS and analyzed by myself and the quantitative model was processed by Paul Plummer, Professor of Geography at the University of Calgary who was commissioned to process the data due to his expertise on econometric modeling. In doing so, it was an attempt to deepen the analysis as my expertise is in qualitative research and this element of the research played a minor part in the thesis. The database included 231 observations but this is a modest sample size and a large number of observations were missing. Owing to the limited sample size the analysis cannot be representative of ART's operations.

Triangulating qualitative and quantitative empirical data allows for greater credibility and robustness of research (Baxter and Eyles, 1997:512):

> 'Credibility refers to the connection between the experiences of groups and the concepts which the social scientist uses to recreate and simplify them through interpretation'.

In doing so, it also allows the methods to be transferable to other case studies verifying the research in the process. Schoenberger (1991) adds that interviews enrich quantitative analysis, highlighting complexities that would not have been identified through quantitative investigation alone.

Conclusions

The research process was an extremely positive experience. If this PhD were to be repeated I would not change many things apart from keeping a detailed research diary on my laptop. Keeping a research diary electronically would have been a useful tool to record my schedule, literature, progress, and the development of ideas.

In conclusion, the purpose of this research is to understand the alternative geographies of finance that are being created by CDFIs in the UK and US and to identify best practice that will contribute to the future development of CDFIs in the UK. This chapter has explored the issues, complexities and methodologies of this research. The use of both qualitative and quantitative data arguably makes this research into the CDFI sector distinctive. The next chapter begins to explore the CDFI sectors in the US and UK and the environment in which they operate.

CHAPTER 4 THE STATE OF THE CDFI SECTOR IN THE US AND UK

This chapter outlines the historical context and development of CDFIs in the US and UK. The chapter begins by briefly introducing the concept of financial exclusion (the finance gap). The role and function of CDFIs are then examined. US CDFIs are explored first to set the context for their UK counterparts. The US CDFIs set an example for the UK in terms of how financially excluded enterprises could be provided with access to finance in marginalized communities. This section illustrates how and why US CDFIs emerged in a series of three phases, the nature of their operations including the size and scale of their activities, and the policy background. This is followed by an analysis of UK CDFIs that follows the same structure. Finally, the chapter compares US and UK CDFIs by highlighting the key issues for the future of CDFIs.

There are two types of financial exclusion; first, personal financial exclusion and secondly, business financial exclusion. What unites these different types of financial exclusion is the inability to access credit, whether it is in the form of an overdraft or a loan. Financial inclusion on the other hand, aims to overcome financial exclusion. Financial exclusion can be overcome by access to a bank account to build a track record or credit history. This is where CDFIs fit into the picture. CDFIs bridge the gap between mainstream financial providers and alternative predatory, illegal and legal moneylenders. In this way CDFIs not only aim to help businesses and individuals access credit they also want to impart a social benefit by providing a means for borrowers to become included into the mainstream financial system (Bryson and Buttle, 2005). Thereby, CDFIs connect the marginalized with the mainstream.

Community Development Finance Initiatives[14] (CDFIs) are a relatively new phenomenon in the US and UK that can be traced back to the 1960s. This chapter identifies the different types of CDFI but concentrates on one type of CDFI, the *Community Development Loan Fund* (CDLF) which will be referred to as a CDFI. Informed by the literature on CDFIs, policy documents and communication with key players within the CDFI sector, this chapter explores the creation and development of the CDFI sector in the US and UK. The academic literature surrounding CDFIs is limited despite CDFIs being a potentially politically and economically valuable policy tool. Research is now being undertaken by a number of academics (Buttle, 2005; Rubin and Stankiewicz, 2001; Rubin with Zielenbach 2006). In comparison, US CDFIs or revolving loan funds as they are formerly known, have been in operation since the 1960s but limited research has been undertaken by academics, Government and the trade associations due to the diversity of the sector and difficulties over data access (Rubin, 2006).

Community Finance in the US and UK

This preliminary section explores what CDFIs are and their diversity. The next section also shows that CDFIs are complex social finance institutions.

Defining Contemporary Community Finance

Community finance incorporates a variety of forms, yet all have the common goals of, first, meeting social and financial objectives and, second, challenging financial exclusion. In these terms, these organizations operate to a double bottom line. Mayo *et al*. (1998:3;

[14] Community Development Finance Initiatives became Institutions up until the introduction of the Phoenix Fund.

HMT, 2001) divides the term CDFI into five financial institutional models: 'credit unions, community loan funds, micro-finance, mutual guarantee societies, social banks' (Table 4.1).

Table 4.1: CDFI Definition

Financial Institution	Definition	Example
Community Development Credit Unions	'Financial co-operatives owned and controlled by their members. They offer savings and loans. Each Credit Union has a common bond which determines who can join it. The common bond may be for people living or working in the same area, people working for the same employer or people who belong to the same association, such as a church or trade union' (CDFA, 2003:1).	▪ North London Chamber, London ▪ Enterprise Credit Union, London
Community Development Loan Funds	Operate within specific disadvantaged areas to sanction loans to SMEs, social enterprises and/or individuals.	▪ Aston Reinvestment Trust, Birmingham ▪ Developing Strathclyde, Glasgow
Community Development Micro-Finance	Small amounts of capital for personal and/or businesses with less than ten employees.	▪ Street UK, Birmingham ▪ The Prince's Trust, UK
Mutual Guarantee Societies	A group of SMEs 'pool their savings in banks, so that they can offer collective guarantees which enhance the value of loans to members and help achieve better lending and deposit rates' than they would as individual companies (Mayo *et al*. 1998:16).	▪ Co-operative Housing Society, UK
Social banks	Offer regular financial services, on a profit making basis, yet have social and/or environmental aims.	▪ Triodos Bank, UK ▪ Charity Bank, UK

The NCCA (2004) definition is essentially a subset of Table 4.1. However, according to the NCCA (2004) there are only four models of CDFI in the US;

1. '**Community development bank**: A for-profit CDFI that is federally regulated, insures deposits, and provides a wide range of banking services to low-income communities.
2. **Community development credit union**: A nonprofit financial co-operative that provides a range of consumer financial services and is owned and operated by lower-income persons, often members of a particular group or tied to a defined geographic area. Federally and state regulated and insured. Services [are] generally offered to members only.
3. **Community development loan fund**: A CDFI that aggregates capital from individual and social investors typically at below market rates and then relends this money primarily to housing developers, individuals, businesses, and community service organizations in lower-income communities. Generally nonprofit and self-regulated.
4. **Community development venture capital fund**: A CDFI providing equity and debt with equity features for small-to-medium-sized businesses. Can be nonprofit or for profit' (NCCA, 2005:47).

The NCCA's definition of CDFI was used for both the US and UK CDFIs as mutual guarantee societies are harder to clarify as CDFIs and all of the other types, including credit unions, can identify themselves as being a type of CDFI. This research focuses on revolving loan funds as these institutions provide access to finance for enterprise. Bryson and Buttle (2005:274) state that:

> 'CDFIs…provide access to finance as well as advice to small businesses. There are many different types of CDFI ranging from credit unions in which members with a common bond save in the form of shares that are re-lent to members to various forms of revolving loan funds, or Community Development Loan Funds (CDLFs), in which a CDFI pools its members contributions and supplements the loan capital with grants or funding obtained from mainstream banks, governments or not-for-profit foundations'.

CDFI loan funds are a relatively new phenomenon in the UK. Here in the UK, they are regarded to be in their 'infancy' compared to the US (Ainger *et al*. 2002:8) where they emerged as a result of local banks shifting their operations towards national and global markets leaving opportunities for providing finance locally. CDFIs have been championed by the UK Government since the late 1990s. However, many social financial institutions in the US and UK developed from the bottom up since the 1960s and 1970s (Mayo *et al*. 1998). Yet it was only when the Government provided support to these types of institutions in the 1990s that they were relabeled as CDFIs in the US and UK.

US and UK CDFIs have social as well as economic objectives. This means that they fulfil a double bottom line, as opposed to a mainstream, single bottom line based around profit maximization. The social objectives of CDFIs hide a myriad of other aims that define CDFI operations; environmental and ethical responsibilities, and equal opportunities. The double bottom line remains at the core of CDFI operations thus unifying their operations despite their complexity and diversity.

The US CDFI Sector

The US CDFI sector emerged in three phases; in the 1960s, the 1990s and the 2000s (Table 4.2). The foundation of *ShoreBank* in the US led to the creation of the first phase of CDFIs in the US during the 1960s and 1970s. The phase was triggered by the civil rights movement and the introduction of the Community Reinvestment Act (CRA) in 1977. In the 1990s, a second phase of CDFIs emerged due to the creation of the CDFI Fund in 1994 by the Clinton Administration, the establishment of a national association of CDFIs, the OFN in 1987 and the strengthening of the CRA by tightening legislation. The third phase of US CDFIs are largely reactive policy tools used to fill gaps in the capital market, depending on where funding is available, for example, organizations have diversified their operations and funds have been created in response to 9/11 and Hurricane Katrina. This section will, first, outline the context and the current state of the US CDFI sector, then go on to explore the policy, support for US CDFIs, nature and operations of US CDFIs, the significance of financial literacy in US CDFI activities and the sustainability of US CDFIs.

Table 4.2: Drivers of the Three Phases of US and UK CDFI Activity

US	UK
1960s/1970s First Phase • Civil rights movement • Deregulation of banking • CRA	*1960s/1970s First Phase* • Industrial and Common Ownership Finance established • Princes Trust established
1980s/1990s Second Phase • Savings and Loans crisis • Rationalisation of bank branches • CDFI Fund	*1990s Second Phase* • Rationalisation of bank branches • National Strategy for Neighbourhood Renewal, Policy Action Team 3, Enterprise and Social Exclusion
2000s Third Phase • *Diversification and consolidation*	*2000s Third Phase* • Phoenix Fund

(Source: Own research)

The First Phase of US CDFIs: The 1960s and 1970s

Along with the civil rights movement, the deregulation of banking in the US in the 1960s and 1970s allowed banks to increase their operations from state-based into national and international operators. CDFIs arose to fill the local banking niche the mainstream banks had withdrawn from. The pioneer of the community bank and the community loan fund was ShoreBank, South Shore, Chicago, USA (Leyshon and Thrift, 1995). The original owners of the bank planned to move from South Shore to the central business district (ShoreBank, 2004):

> 'The reasons for this relocation were related to the demographic, economic and racial transformations which the area had undergone during the 1960s and early 1970s…' (Leyshon and Thrift, 1995:324).

The bank was taken over in 1973 by a group of altruistic entrepreneurs. The new owners of ShoreBank had experience in banking, social services and social justice. Fundamentally, they believed that a mainstream bank with both social and economic objectives could revitalise deprived local economies (ShoreBank, 2004). Through ShoreBank's loan fund, the bank supported entrepreneurialism in the area by administering financial support to micro-enterprises and small businesses and by sanctioning mortgages to residents of South Shore, ShoreBank demonstrated that redlining was a discriminatory and ultimately unsound practice. ShoreBank set out to justify its belief that the financially excluded, those on low incomes and ethnic minorities, could be bankable. By reaching out to the financially excluded, ShoreBank now fulfils a triple bottom line in that it aims to create a social, economic and environmental return (ShoreBank, 2004).

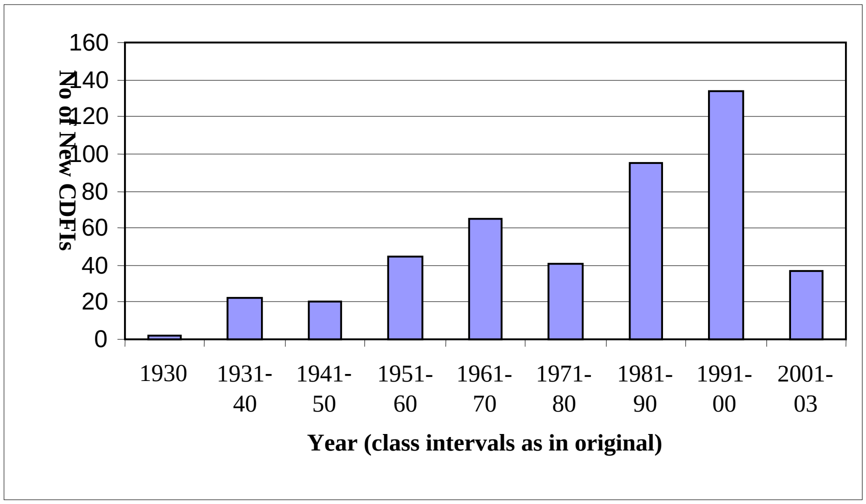
ShoreBank's mission has remained consistent in that it has sought to invest in 'people and their communities to create economic equity and a healthy environment' (ShoreBank, 2004). Despite making serious losses during the first two years of trading, ShoreBank has since invested over $1.7 billion in community development, with $220 million being invested in SMEs and $540 million in real estate (ShoreBank, 2004). In 1978, ShoreBank extended its activity from serving low to moderate income areas in the Chicago area by establishing a housing development company (a not-for-profit organization) and an ethnic minority venture capital fund (ShoreBank, 2004). By 1986, ShoreBank began to reproduce its model of lending to underserved communities elsewhere in the US. As a result ShoreBank doubled in size and merged with *Indecorp*, a

Chicago based ethnic minority bank (ShoreBank, 2004). ShoreBank has expanded further across America and into emerging markets in Eastern Europe, Africa and Asia (Mathison, 2003). Emerging markets are sectors with potential high growth in developing countries. By investing in new markets, ShoreBank remains innovative and progressive. ShoreBank emerged and remains a pioneer of community finance by innovating new products and services whilst continuing to be competitive on a local and international scale.

The Second Phase of US CDFIs: The 1990s

The finance gaps created by the savings and loans crisis in the late 1980s and the rationalization of bank branches in a cost cutting exercise arguably stimulated the second phase of US CDFI development. At this time in the 1990s, US CDFIs took on the role of local banks, keen to match local knowledge with local products and services. As Figure 4.1 shows, there was a steady growth of CDFIs in the 1980s but this was surpassed by the number of CDFIs being established in the 1990s. In addition, the CDFI Fund, which was launched by the Clinton Government, supported the development of CDFIs and encouraged new CDFIs to form. However, it is also likely that organizations that operated in a similar way to CDFIs began classifying themselves as CDFIs rather than new CDFIs being established.

Figure 4.1: Number of New CDFIs in US (1930-2003)



(Source: NCCA, 2005:8)

The Third Phase of US CDFIs: The 2000s

The third phase of CDFI development was a consolidation phase, when a number of CDFI mergers occurred (Baue, 2006). To date, there are no precise figures for the number of CDFIs in operation across the US as CDFIs are unregulated and membership of the trade association is not compulsory. The number of CDFIs is estimated to be currently between 700 and 1000, located in both rural and urban areas (Table 4.3), although the number of CDLFs in the USA is estimated to be around 400 (Table 4.4) (NCCA, 2004). Credit unions and loan funds are the most popular mechanism for delivering finance to underserved markets (Table 4.4). This also reflects the need for savings facilities that are offered by credit unions as well as debt finance that loan funds and credit unions provide. However, it also highlights the limited response that the CDFI data project has had in collating information on US CDFIs[15].

[15] The diversity of CDFI operations and the challenging nature of measuring CDFI performance is demonstrated through the limited research undertaken even by national trade associations such as the OFN.

Since 2002, the creation and growth of CDFIs has slowed and a small number of CDFI mergers have occurred (Figure 4.1) (NCCA 2004). The OFN has a small proportion (just over 1.5%) of these CDFIs as members (NCCA, 2004). This is because the OFN requires members to have a track record of activity; members of the OFN have a developed lending portfolio[16] and are working towards sustainability. The majority of CDFIs operate in a single town, city or metropolitan area or in multiple counties (NCCA, 2004). Since the start of the data collection to the end of the 2003 financial year, US CDFIs had sanctioned over \$8.8 billion in finance, and created and/or preserved 167,000 jobs (NCCA, 2005:5). Currently, the average loan size varies between \$9,327 and \$90,174 depending on the market sector (Table 4.5). The key features of the US CDFI market are that a considerable percentage of its lending portfolio is for affordable housing and community projects (Ainger *et al*. 2005). The majority of loans are secured (principally against real estate), default rates are low, interest rates are competitive (with mainstream banks), and the institutions themselves are supported by the CRA. This implies that the USA CDFI sector has reached some degree of maturity or development. This is due to changing State and Federal Government policy and structures, rationalization of bank branches in disadvantaged areas, market demand and the stage of the economic cycle. Nonetheless, the USA CDFI sector is constantly innovating and diversifying.

[16] A developed lending portfolio is where a CDFI balances its sources of funding and lending activity.

Table 4.3: Rural-Urban Distribution of US CDFIs

Location of US CDFIs	%
Major Urban Area	40
Minor Urban Area	27
Rural	33

(Source: NCCA, 2005:12)

Table 4.4: Number of CDFIs in US in 2003

No of CDFIs		% of market share
Community Development Banks	32	7
Community Development Credit Unions	265	56
Community Development Loan Funds	159	33
Community Development Venture Capital	21	4
Total No of CDFIs	**477**	100

(Source: NCCA, 2005:5)

Table 4.5: Median Loan and Investment Size by Sector in US 2003

Sector	Amount	%
Business	70,000	32
Housing	45,416	21
Micro	9,327	4
Personal Development	4,476	2
Community Services	90,174	41
Total	**219,393**	**100**

(Source: NCCA, 2005:17)

US CDFIs have substantial amounts of capital which they can lend to clients. Net loan loss default rates are below 1%, with a 90 day delinquency rate of 3.5% (NCCA, 2005). Significantly, if a loan repayment is late, the loan is rescheduled (NCCA, 2004). This conceals or decreases the actual default rate. Also, to complicate matters, default rates of each submarket are combined in the annual reports. Table 4.5 shows the proportion of lending in each market. The lower the level of lending could be equated to a high risk market, which is balanced by loans made in lower risk markets. For example, micro enterprise lending accounts for 4% of all loans, where little security is available if at all, compared to community services which account for 41% of loans and are usually guaranteed through property. Moreover, technical assistance and the monitoring of clients is built into the lending and monitoring process ensuring that the loan can be managed through the relationship with the loan officer that is developed as part of the loan application process. The close relationships that are developed between loan officers and clients increases the financial understanding and literacy of clients which may ensure that clients are no longer financially excluded from mainstream banking.

The data outlined above reveals the scale and achievements of US CDFIs since their conception. It is worth noting that US CDFIs appear to be reluctant to exchange information, contribute to the data project and become a member of the US CDFI national trade association. This suggests that the US CDFI sector lacks cohesion and there is competition for funding from Government, foundations, religious institutions, and in some cases, clients, within the sector.

Evolving US Policy Context: Regulation and the Operations of US CDFIs

The US has a long history of state and local banking. However, the rationalization of banks, as a result of the liberalization of US banking laws in the 1970s, witnessed many financial institutions withdrawing from communities. This created friction between local communities and the banks that had moved out of local economies. Essentially, this desertion by banks highlighted the need for reinvestment in the most deprived areas, notably the inner cities. In the early 1970s, grassroots organizations and banks in Chicago reconciled their divergent needs by reviewing the lack of finance and insurance available to those in 'unsafe' neighbourhoods as well as racial discrimination in financial services. The Community Reinvestment Act (CRA) framework was developed to counter discrimination, disinvestment and redlining (Pinsky, 2005). Subsequent Government legislation created the US CRA in 1977 which was designed to make financial institutions accountable for their actions in the communities they served.

The CRA was the start of strategic community finance designed specifically to redevelop local economies and encourage regeneration. The key elements of the CRA are the lending, service and investment tests which require financial institutions to disclose their activities to regulators (OCC, 2005). Financial institutions failing to comply with the CRA have sanctions imposed upon them (OCC, 2005). By disclosing lending information, banks can identify market gaps and their behaviour rating system can impact upon the banks' reputation as a poor score would indicate that the bank is failing to meet the requirements of the community (Marshall, 2004). The aims of the CRA are to ensure that; first, all the community's credit requirements are met, second, redlining is restricted, and third, financial activity in low to moderate income areas is regulated. The CRA 'encourages commercial banks and savings associations to help meet the credit needs of the communities in which they are chartered, consistent with safe and sound banking practices' (Avery *et al*. 1997:713). The CRA ignores the practices of mortgage and pension companies which weaken the CRA and does not prevent discrimination against those in low and moderate income areas. Therefore, the CRA is not inclusive of all financial practices. To gain CRA approval, banks must pass the 'service test' whereby they are tested on the distribution of branches (which should be evenly spread across all communities), monitor the opening and closure of branches, the applicability of services provided by the bank to each community and the general accessibility and effectiveness of the bank's services (Avery *et al*. 1997:714). If banks fail to meet the CRA's criteria, negative publicity will impact upon their level of business and in extreme cases could even result in protests by the communities deserted by the financial institutions. It is interesting to note that few banks have received negative reports, with only 1% of financial institutions being identified as non-compliant or in need of operational improvement to comply with the CRA (Marshall, 2004). This could be due to the high cost and reputational risk of institutions that fail to meet the needs of their local communities.

The CRA made banks more accountable and their activities more transparent, which could have made disillusioned investors put their trust in financial institutions through the introduction of new products, services, business opportunities, partnerships, markets and delivery systems. Over the last twenty years restructuring of the US financial industry has been driven by technological advances that have tended to transform relationship banking to an arm's length relationship between banks and client. One indication of this has been the use of credit scoring and also branch closure (Avery *et al*. 1997; Bitler *et al*. 2001; Dymski and Veitch, 1996; Leyshon and Thrift, 1994, 1996, 1995, 1997, 1999; Martin, 1999). The restructuring of the financial sector means that financial institutions continue to shift their activities away from underserved, unprofitable areas to lessen their exposure to risk. Nevertheless, the CRA changed banks' perception of profitable lending and investment in historically underserved markets. Moreover, the CRA changed the behaviour of banks. In practice, the CRA monitors the services and branches of banks in low-moderate income communities. Financial institutions are assessed approximately every 2 years (Pinsky, 2005). The CRA has the power to delay or deny a merger and deny or delay a request to expand an existing branch or open a new branch, but perhaps the most significant of all is the damage that can be inflicted on a bank's reputation and profits if a bank is perceived as not serving the needs of communities (Pinsky, 2005).

This includes access to products and services (e.g. mortgages, credit facilities). Yet Banks can choose a regulator for each aspect of their lending and can change regulator. This can threaten the viability of the CRA as banks can choose a less thorough or damaging report (Pinsky, 2005). Nevertheless, the CRA has had a positive impact on bank provision in low and moderate income communities.

US banking regulation at a national and state level is highly fragmented owing to differing state powers; it is highly politicized and often contradictory due to federal banking regulation. For example, the CRA is overseen by four different regulatory bodies: the Federal Reserve, which looks after banks active in the US; the *Federal Deposit Insurance Corporation* (FDIC), which insures bank deposits and is the chief 'regulator of state-chartered banks that are not members of the Federal Reserve Board'; the *Office of the Controller of the Currency* (OCC), which monitors national financial institutions; and the Office of Thrift Supervision, which monitors federal and state thrift institutions (Marshall, 2004:252). Owing to the different institutions that monitor the activity of financial institutions, the level and influence of CRA and banking regulation is questionable and is unlikely to be consistent between States. As banking regulation is both at the national and state level, the US has a system that is locally embedded (Marshall, 2004). The US top-down and bottom-up approach sees a coordinated effort in tackling financial exclusion. US public-private partnerships have been forged as a result of the CRA which has led to financial institutions becoming embedded within local communities thus stimulating local economies and regeneration.

The nature of the CRA exercise has served as a public relations tool for banks so it has not become overly burdensome for them. Banks' experience of the CRA has been more positive than negative, as lending to low and moderate income communities has shown that there is a market in lending in such areas. The Chief Executive Officer of the OFN, Mark Pinsky, believes that the CRA should be extended to include pensions and mortgages (Pinsky, 2005). Speaking on behalf of the OFN (2005), Pinsky believes that, in the future, banks will adopt CDFIs' business strategies as CDFIs know how to lend successfully in emerging markets. Emerging markets are defined as areas that show potential for investment, and in the case of CDFI activity, this is usually at the geographic frontier of deprived areas:

> 'A successful CDFI is perhaps best compared to a niche venture capital firm that deploys its superior knowledge of an emerging market niche to invest and manage risk better than other investors. CDFIs are often 'early birds' or 'market scouts' who see the market potential of overlooked customer segments. But there is a clear market test involved. Like other frontier investors, CDFIs cannot survive unless they find paying customers. They must make loans and investments that are repaid. And, in the end, they must aim to be supplanted. By definition, CDFIs' customers are not yet fully served by the market. But the end goal is always to change the psychology of the marketplace to catalyze more investment by the private sector' (Summers, 1998:1).

CDFIs are working in niche markets and whilst they are working with excluded groups, they have to mitigate risk through due diligence and approving loans that have the greatest chance of being repaid or being underwritten by state guarantee funds. However, in the US banks have become increasingly competitive due to the restructuring of the financial industry and CDFIs are not lenders of last resort which, in some instances makes banks and CDFIs compete with each other for viable deals. Also, CDFIs require funding from the private sector in addition to public sector support and their revolving loan fund. The CDFI sector has adopted banking terminology such as ‘emerging markets’, to attract investment. Yet this has not drawn sufficient capital to the industry because investors are risk averse and are not necessarily interested in the emphasis placed by CDFIs on fulfilling a double bottom line. The weakening of the CRA under the Bush Administration has resulted in fewer investments being made to deprived areas (Rubin, 2006) and CDFIs have become increasingly significant for those who are financially excluded, including people on low incomes, ethnic minorities and women (NCCA, 2004).

Opportunity Finance Network (OFN)

The trade association for US CDFIs, OFN, was formed in 1986 as the *National Association of Community Development Loan Funds* (NACDLF) to support community development loan fund activity but changed its name in 1997 to the NCCA to increase its membership to include community development credit unions, community development venture capital funds, micro-enterprise lenders, and CDLFs. The NCCA re-branded itself in Autumn 2005 to become the OFN to attract new investment into the sector. To date, it has a network of over 160 CDFI members (NCCA, 2005). The aims of the OFN are to provide finance for CDFIs; training and support for CDFIs and their investors; and to communicate performance and impact on behalf of the CDFI sector (NCCA, 2005).

CDFIs 'aim to achieve a double bottom line [by] achieving both social, and ultimately financial returns' (Ainger *et al*. 2002:25). The OFN have benchmarked the performance of CDFIs through the CDFI Assessment and Rating System (CARS) programme, to identify and to highlight the benefits of the industry. Such benefit targets include job creation and preservation, improving housing, welfare and entrepreneurial skills (NCCA, 2004). Measuring the impact of CDFI activity in their operating area would increase their accountability and enable them to attract additional investment. By attracting further investment, many CDFIs can become sustainable in the long term and/or take on additional risk as CDFIs are currently undercapitalized (Ainger *et al*. 2002).

Support for US CDFIs

In 1994, the US Government created the Community Development Finance Institutions Act to grant direct funding to CDFIs and for bank subsidiaries promoting community reinvestment. The CDFI Fund was created under the Reigle Community Development and Regulatory Improvement Act (1994) to promote access to capital, stimulate local economic growth by supporting and training CDFIs and allocating tax credits through the New Markets Tax Credit Program (NMTC) which is designed to encourage private investment into CDFIs (CDFI Fund, 2005a; NCCA, 2004). The CDFI Fund consists of the Bank Enterprise Award (BEA) programme that provides an incentive for banks to invest in local CDFIs and specialist support and funding for Native American CDFIs (CDFI Fund, 2005a; NCCA, 2004). The CDFI Fund supports the following community financing activities in disadvantaged areas:

> ‘Affordable Housing Loans, Affordable Housing Development Loans and Related Project Investments; Education Loans; Home Improvement Loans; Commercial Real Estate Loans and Related Project Investments; and Small Business Loans and Related Project Investments’ (CDFI Fund, 2005b:8).

Since the CDFI Fund was established it has awarded over $700 million to CDFIs and attracted over $8 billion through its NMTC initiative (CDFI Fund, 2005a; NCCA, 2004). The 1994 act, recognized that lending to those on a low and moderate income could be profitable and the legislation was constructed for financial institutions to take advantage of untapped markets which also fulfilled banks’ CSR agenda. However, the Bush Administration has halved the funding available to CDFIs under the CDFI Fund from $118 million in 2001 to $55 million in 2006 (Rubin, 2006). Nevertheless, with the assistance from Government and mainstream financial institutions under the CRA, the US CDFI sector has grown into a valuable industry.

The Nature and Operations of US CDFIs

US CDFIs, like mainstream financial institutions, adopt a risk averse approach despite lending to at risk groups by securing collateral to guarantee each loan. Interest charges depend on the sector and the associated level of risk. For instance, the highest level of interest is for micro-enterprise at 8.8%, compared to housing to individuals (as opposed to organizations) at 5.0%. The average interest rate is 6.9% (NCCA, 2005:6). The case for these variable interest rates stems from the fact that CDFIs are not a cheap source of finance but are helping excluded groups access finance at a viable rate of repayment in order to make them bankable in the future. Interest rates must be set above the bank rate to cover the risk associated with the loans and the rate must also go some way to ensuring that a CDFI is financially sustainable in its own right. As all loans are secured, default rates are low, interest rates are competitive, and the institutions themselves are supported by the CRA, thus embedding the CDFI sector within the US.

Collectively, US CDFIs understand that banks are risk-averse and that many people living in low-income areas are financially excluded. According to Mayo *et al*. (1998:41) near-bankable business proposals can access finance through 'subsidies or off-loading costs onto borrowers and through partnerships between banks' and CDFIs. Banks can offload risk to CDFIs by only investing up to an amount which can be secured, and the CDFI can top up the rest of the loan required. For example, if a business start-up requires $100,000 and the bank only approves $75,000, a CDFI can top-up the loan to the full amount required. CDFIs work in partnership with the public, private and voluntary sectors to fund business and social enterprise, personal consumption and housing projects. Arguably, through this partnership, CDFIs have made many excluded individuals and firms bankable through understanding the needs of their local market. CDFIs have made the financially excluded bankable because of their networks, being embedded in the communities that they serve and willingness to lend to this market.

The welfare system in the US differs to that of the UK, as the public sector plays a limited role. Social housing, for example, is largely non-existent in the US, so many CDFIs offer loans for the construction of social housing: '*Community or Neighbourhood*

Land Trusts are specialized non-profit membership organizations established to hold land for the benefit of specific communities' (Mayo *et al*. 1998:42). As such, 21% of CDFI lending is for social housing in order to preserve affordable housing for those on low incomes (Table 4.5). As well as providing finance for housing, US CDFIs offer finance for the not-for-profit sector which allows social enterprises to purchase and/or redevelop property, which itself can act as security against the loan (Mayo *et al*. 1998). Community loans comprise 41% of US CDFI loans. Another major proportion of CDFIs lending goes to micro-enterprises and small businesses which, when combined, totals 36% of CDFI lending (Table 4.5). To avoid the risks involved in small firm start-up, US CDFIs concentrate their lending on enterprises over a year old and micro-finance from start-up to growth (Mayo *et al*. 1998). In addition to this, some CDFIs secure each of their loans and any deficits are met by the US Government's *Small Business Administration's* guarantee scheme (SBA) and MicroLoan[17] programme, which provide up to 80 percent of the guarantee for the loan (Mayo *et al*. 1998). Through guaranteeing each loan, CDFIs are able to maintain competitive interest rate levels for their clients (NCCA, 2004). Interest rates are, however, set higher than those available from mainstream financial institutions. It could be suggested that as US CDFIs require security for each loan they are risk averse and are trying to reach financial sustainability fast.

Financial Literacy

Financial literacy programmes are defined as training and technical assistance (which is dependent on the type of loan, for example writing a business plan or managing a current

[17] The US MicroLoan program gives funding to non-profits, such as CDFIs, to make loans (up to $35,000) and technical assistance to micro enterprises.

account). Technical assistance is offered alongside a CDFI loan to give the borrower the best chance of succeeding in business and repaying the loan. Technical assistance is tailored to the needs of the borrower and can range from attending classes on marketing to a referral to an accountant. The Fair and Accurate Credit Transactions Act of 2003 revised the Fair Credit Reporting Act largely to improve the transparency of credit information for consumers as well as increase the level of financial literacy through education (Avery *et al*. 2004). Braunstein and Welch (2002) suggest that relationship lending is essential to take into account the level of financial literacy. Increasing financial literacy ensures that as the state retreats from welfare support, banks attract more business. CDFIs are bridging the gap between the excluded and the mainstream as well as improving financial literacy making individuals and firms bankable in the future. Coincidently, CDFIs are monitoring their investments and ensuring that the loans are being repaid through external financial literacy programmes.

Sustainability

US CDFIs may have demonstrated that a finance gap exists in the low and moderate income market. However, the market has shifted as a result of banks becoming increasingly competitive and CDFIs have had to adapt accordingly. This means that successful US CDFIs must be flexible and dynamic financial institutions. The OFN (2004:3) reports that:

> ‘the US CDFI industry is changing rapidly as a result of changes in economic and demographic trends in the communities CDFIs serve as well as shifts in public and private funding sources’.

CDFIs are funded by financial institutions (under the CRA), not-for-profit foundations and Government's CDFI Fund and the SBA (NCCA, 2005). Yet under the Bush administration, CDFIs have seen considerable reductions in the level of financial and CRA support due to the present state of the US economy (NCCA, 2004). The CDFI Fund has decreased in recent years and the level of investment required by banks to fulfil their CRA objectives has also been reduced, which has resulted in a reduction in CDFI lending capital. The decrease in the CDFI Fund has had a knock on effect upon those who are financially excluded as the funds are not sufficient to meet demands, nor can funds account for the high level of risk or cost of small loans to those in low and moderate income communities. Without financial subsidies from investors and the Government, many CDFIs may face closure as they have been myopic and relied on policy, rather than becoming independent by developing their own portfolio and reserves from the outset. Operational sustainability, therefore, is another key challenge for CDFIs.

Financial sustainability is essential for any business to be a success. Yet CDFIs have to fulfil the double bottom line. Consequently, sustainability is harder for not-for-profit CDFIs to attain than for-profit businesses owing to the reliance on external grant funding and the markets associated with their lending. CDFIs aim to be sustainable in the long term with their loan fund providing sufficient capital for lending and revenue for operational costs. This is to ensure that CDFIs can operate without public subsidy yet can continue to function and also mitigate exposure to risk. According to Ainger *et al.* (2002:25):

> ‘CDFIs are performing well if they reach 60-80% financial sustainability. Others argue that the industry has been overly subsidy-dependent, which has had a negative impact on productivity and efficiency’.

The OFN (2004) has stated that many CDFIs are working towards self-sufficiency by staying competitive (compared to mainstream financial institutions and their non-profit counterparts) and introducing higher fees, working in partnership with other CDFIs, managing capital more effectively, and re-evaluating their operations to determine which cost saving strategies would be most appropriate, for example, reducing operating costs, and outsourcing of resources, staff, and back office operations. Outsourcing parts of the CDFIs business to other not-for-profits has created alliances within the sector. CDFIs that specialize in back office activity can offset the risk of lending by having another income from managing borrowers’ loans for other CDFIs. Some CDFIs have diversified their products and services to include business advice services and equity finance, whilst others have reduced their lending activity by focusing on the most visible and beneficial (to the community and CDFI) sectors such as community facilities and housing (Rubin, 2006). Sustainability can conflict with the double bottom line as CDFIs are targeting high risk clients to fulfil their social and financial objectives. CDFIs sustainability may undermine the ability of a CDFI to target unbankable businesses and instead encourage them to develop lending strategies that closely mirror those in operation in the mainstream financial institutions. It could be argued that US CDFIs complement the mainstream financial institutions as they have demonstrated that previously underserved markets can become bankable so long as the risk is mediated by the State and other non-profit organizations. Some US CDFIs may be comparable to US banks as many operate on a state, national, and even international scale, and control significant financial resources.

US CDFIs are designed to occupy niche markets, serving excluded groups in deprived areas. Despite their longevity, US CDFIs are continually challenged. CDFIs must constantly innovate and diversify their services and products to bridge the gap between commercial services and alternative lenders. For example, the financially excluded face barriers to accessing mainstream finance so they turn to predatory lenders that can offer loans and mortgages. However, the high cost of these financial products can lead to untenable repayments and homes being repossessed (Pinsky, 2005). CDFIs, therefore, aim to provide an alternative to predatory lending and mainstream finance. The activity of CDFIs indicates that the funding gap continues to exist in the US despite the creation of the CRA. The CDFI sector remains diverse and relations with banks are varied and individualized depending on CRA effectiveness and the level of funding support from mainstream banks. CDFIs are likely to become increasingly significant in the future due to the continued need for welfare support. Some important elements of the US CDFI movement have been transferred to the UK especially in terms of the provision of loans that meet the conditions of a double bottom line as well as lending locally via relationship banking. Yet it remains to be seen whether UK CDFIs will have the same longevity and success as their US counterparts as they develop in response to a set of different policy and institutional contexts.

The UK CDFI Sector

Like their US counterparts, UK CDFIs have emerged in a series of three phases; the first in the 1960s and 1970s, the second in the 1990s and the third in the 2000s. Despite these similarities with the US CDFI development, the drivers of those phases are different. It is important therefore, to note that the development of CDFIs in the UK did not follow the US pattern. UK CDFI activity is on a far smaller scale compared to the US; UK CDFIs are generally small, are restricted in the types of finance that they offer (due to funding limitations) and are relatively young organizations. In addition, the policy framework surrounding UK CDFIs is weak compared to that which has developed in the US.

In the UK, CDFIs operate in a diverse range of financial markets. UK CDFIs can offer personal finance in the form of savings, current accounts and loan facilities, business finance such as loans (Charity Bank and *Triodos Bank* also offer insurance and savings facilities), finance for social enterprises (socially orientated businesses, that are largely not-for-profit) and less commonly, loans for home improvement (CDFA, 2004b). The CDFA, the trade association for UK CDFIs, defines CDFI as:

> 'a new financial tool for social, economic, and physical renewal in under-invested communities. They lend and invest in deprived areas and underserved markets that cannot access mainstream finance. They are sustainable, independent organizations that provide financial services with two aims: to generate social and financial returns. Some CDFIs offer loans while other provide equity investment – a few offer them both. They serve different types of customers including individuals, micro, small and social businesses' (CDFA, 2004b:1).

However, it is misleading to state that CDFIs are sustainable from their outset as CDFIs aspire to become sustainable or independent of public funds due to the risks involved in lending to the financially excluded.

UK CDFIs are also diverse and dynamic and shift according to market and funding requirements. However, CDFIs can be defined collectively as independent financial institutions that provide capital and support to empower individuals or organizations at the edge of commercial margins to develop opportunity and wealth in disadvantaged areas. The term CDFI is used to include a range of different business structures, operations, markets. As such, it is questionable whether UK CDFIs are creating a coherent sector or movement.

The future of CDFI funding in the UK is uncertain as it is anticipated that there will be a shift from public to private investment in CDFIs and potential and existing investors may require positive performance to verify that their investment is justified. For private investment to be interested in CDFIs, there needs to be a certain level of awareness and their missions need to be clear. This and other issues are explored in the next section.

The First Phase of UK CDFIs: The 1960s and the 1970s

The UK has an uneven history of community finance. Even though co-operatives have existed since the 19th century, the first phase of community finance began in the 1960s with the creation of community credit unions (Brown *et al.* 2003; Collin *et al.* 2001). In 1971, Triodos Bank the UK's first national social financial institution was established to provide loans to social enterprises; Triodos fulfils a double bottom line of generating social and economic returns. The second social financial institution to be established was the *Industrial Common Ownership Finance Ltd* (ICOF). ICOF started a revolving loan and savings fund for co-operatives and social enterprises in 1973 (see www.icof.co.uk) and the Princes Trust was founded in 1976, a youth charity giving young, disadvantaged entrepreneurs the opportunity to become self-employed by grants and micro loans. From this, the significance of social financial institutions has grown and there are now over eighty CDFIs in the UK.

The Second Phase of UK CDFIs: The 1990s

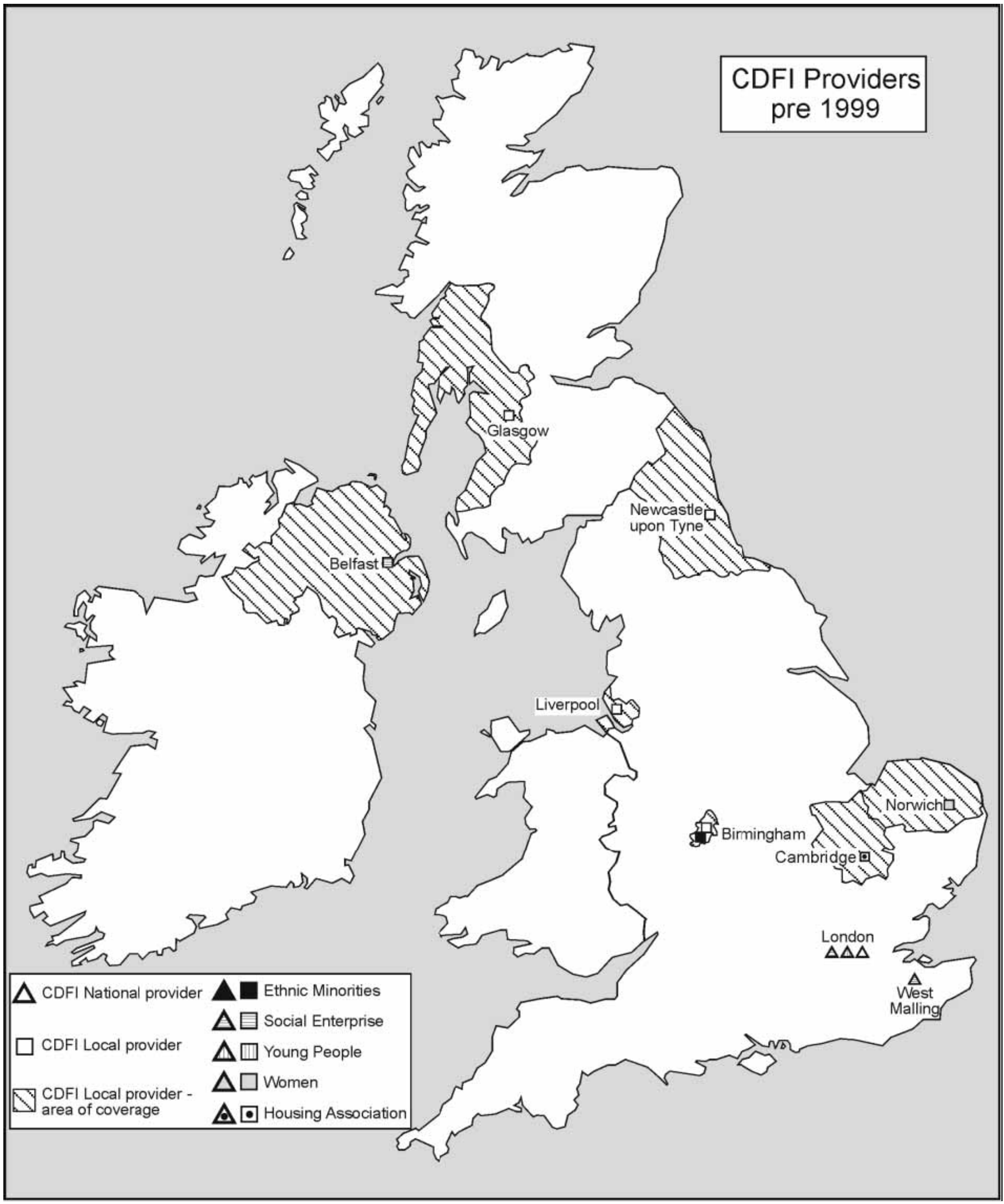
The concept of CDFI was constructed in the US in 1994 and applied formally to the UK by the Labour Government in 1999 (NSFNR, 1999). However, a number of social financial institutions such as the ART (1997) existed prior to the application of the CDFI label in the late 1990s. Inspired by the success of the pioneering community finance initiatives in the UK and the increasing need for finance for excluded groups, the second phase of community finance developed in the 1990s (Collin *et al*. 2001). The development of community finance in the UK in the early 1990s began with the formation of DSL (1993). These institutions along with the US experience inspired a national initiative for the creation of revolving loan funds.

The Third Phase of UK CDFIs: 2000s

The UK CDFI sector has grown considerably since 1999 with the introduction of the DTI's Phoenix Fund[18] (Collin *et al*. 2001) (Figure 4.2, 4.3, 4.4). The UK CDFIs created post 1999 can be identified as the third phase of CDFIs as these organizations were largely established in response to Government policy and as such are project based CDFIs that shift their operations in response to available funding streams. There were six CDFIs in operation in the UK prior to 1994 and over eighty CDFIs with revolving loan funds in operation today. The growth of the sector during the 2000s and the introduction of the Phoenix Fund allowed the UK CDFI sector to grow and experiment.

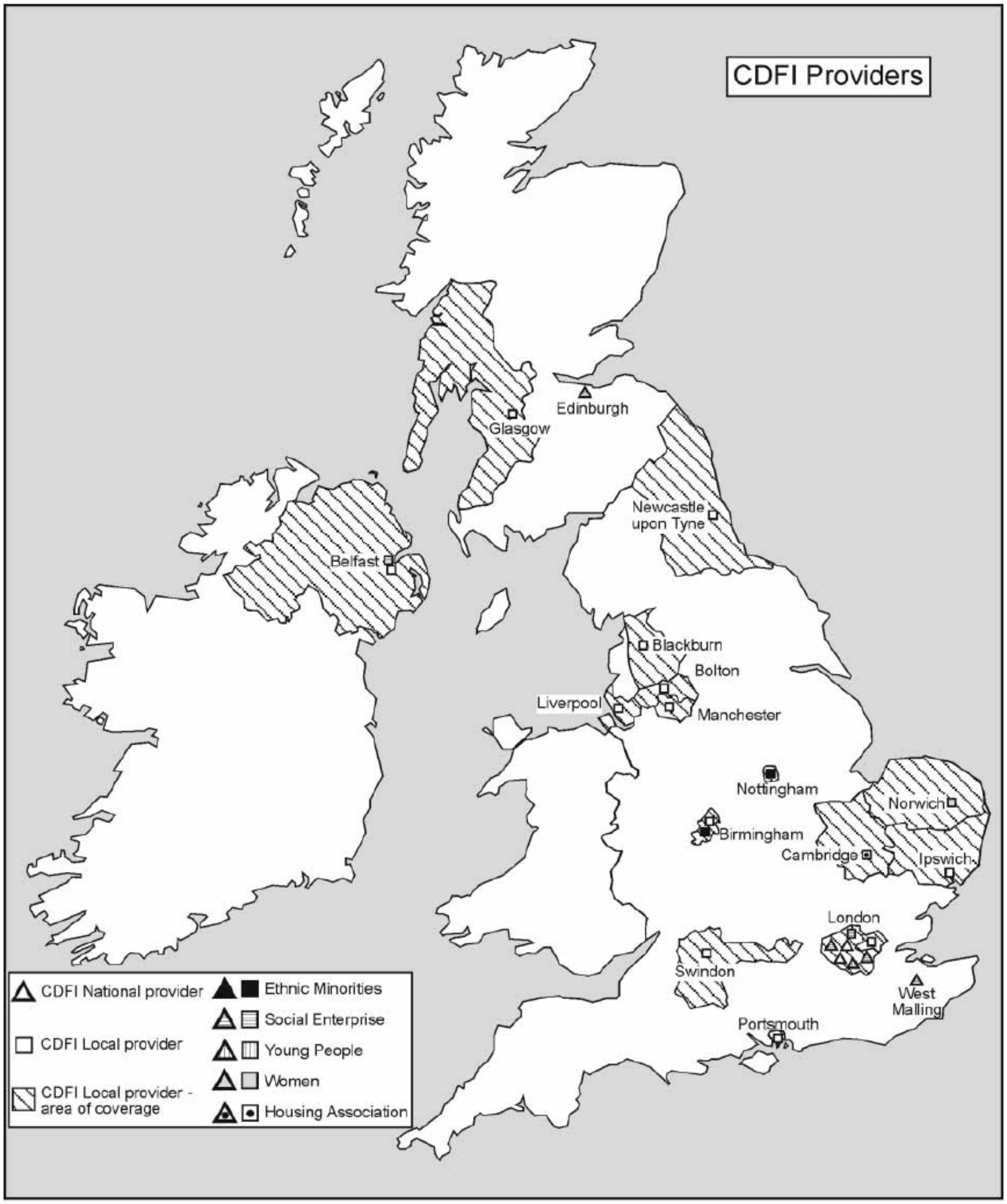
[18] The *PAT 3 report* recommended the creation of the Phoenix Fund, a challenge fund to provide revenue, capital and/or loan guarantee support in order to deliver loans to businesses in deprived areas with a bottom-up, flexible approach for part funding CDFIs (NSFNR, 1999).

Figure 4.2: The Regional Geography of Community Development Loan Funds in the UK up to 1999



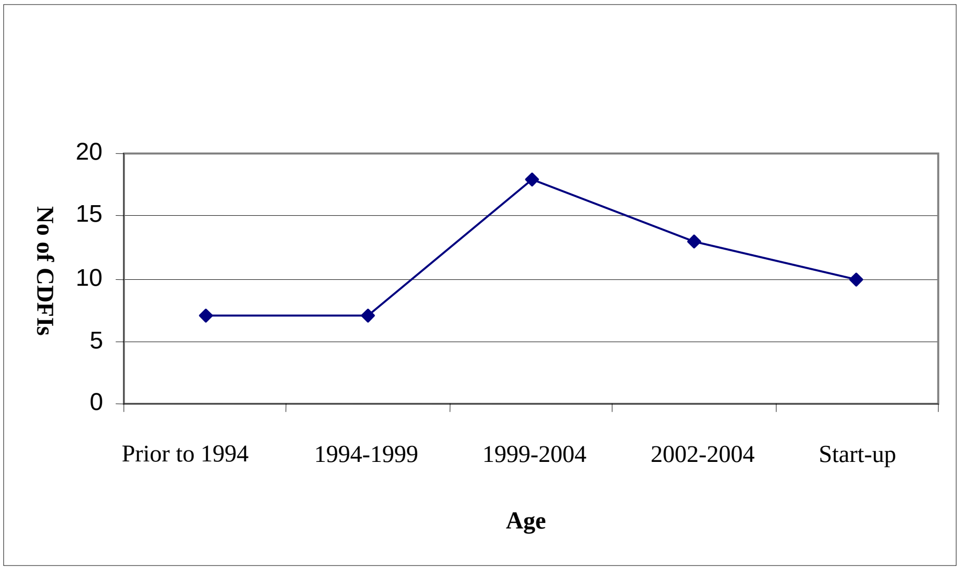
(Source: Bryson and Buttle, 2005:282)

Figure 4.3: The Regional Geography of Community Development Loan Funds in the UK up to 2003



(Source: Bryson and Buttle, 2005:283)

Figure 4.4: Age of UK CDFIs in 2004



(Source: CDFA, 2005:12)

CDFIs vary in their structure. Some CDFIs have been established by altruistic individuals, local authorities, enterprise agencies or in response to the Phoenix Fund. The majority of CDFIs have a group company structure, for example, they are IPS and Company Limited by Guarantee. Other CDFIs have a single company structure (again tending to use Company Limited by Guarantee) but an increasing number are selecting to use charitable status. Some UK CDFIs have borrowed CDFI models from other institutions (such as *Street UK*, that were inspired by micro finance institutions in Eastern Europe) which have been successfully established elsewhere but have experienced problems as they have not directly addressed the local market and have failed to become locally embedded. In this way, the top-down development of CDFIs may not always be appropriate to the market as the CDFI may need to change to fit the needs of the community. Therefore, CDFI flexibility and local knowledge are key factors for success. Many CDFIs are in the early stages of growth and are on a steep learning curve in developing their operations and lending activities and this is reflected in high default rates.

Table 4.6: Geographical Market Served by UK CDFIs

Geographical Area	No of CDFIs
Town/city	11
Sub-region	25
RDA region	7
England	4
Scotland	1
N Ireland	2
UK	5

(Source: CDFA, 2005: 14)

The UK trade association for CDFIs, the CDFA undertakes an annual survey to generate information about the UK CDFI sector in order to measure progress. Over 40% of CDFIs are in the first year of financing or are yet to start financing. The research undertaken by the CDFA would be more robust if the research was divided into those CDFIs that had been fully operational for longer than two years and CDFIs that are under two years old (CDFA, 2005). The CDFA (2005:4) admits that the 'ability to report on performance remains mixed' and results are blurred due to the diversity and youth of the CDFI sector in the UK. CDFIs tend to be concentrated in urban areas, particularly that of 'the North-

West, London and the West Midlands' (CDFA, 2005:4). Nearly half of UK CDFIs operate at a sub-regional scale (Table 4.6) (CDFA, 2005:14).

Due to the diverse nature of the UK CDFI sector, not all national CDFIs incorporate every financial need and tend to concentrate on a specific market, which continues to leave finance gaps. As such, there is geographically uneven development of CDFI activity across the UK. Thus, Scotland, Wales, the South, East Midlands, East Anglia, North-East and rural areas of the UK may suffer the greatest financial exclusion by enterprise due to the lack of CDFI activity in those areas. The average size of loans to individuals is £500, compared to £5,200 for micro-enterprises, £28,000 for SMEs and £50,000 to social enterprises (Table 4.7). As such, established social enterprises have the greatest lending value and also lowest risks. However, there are very few loans sanctioned to social enterprises (5.5%) (Table 4.8). Social enterprises tend to rely on public sector grants, are able to access finance from mainstream sources, are unaware of their options, or are risk averse (BOE, 2003). The majority of CDFIs specialize in micro-finance, which includes personal and business finance (Table 4.8). Yet personal and business start-up finance is extremely high risk as the majority of loans in the UK are unsecured. Also, smaller loans are expensive to administer and cost the same as larger deals from social enterprises. In this way, CDFIs need to balance their risk/reward ratio with every loan that they assess, in accordance with their missions and their sustainability strategy. CDFI operations vary by sector, geography and type of financial instrument, for example, finance for enterprise. CDFIs also deal with a diverse range of markets and supply different products (Table 4.9). There is little coherence and no simple pattern of CDFI activity in the UK. This analysis reveals the diversity of finance that is offered by

CDFIs and how it is difficult to define and identify a unified sector. However, it is important to note that successful CDFIs respond to changes in the external environment so CDFI operations change over time.

Table 4.7: Average Loan Size of UK CDFIs in 2004

Type	Average Loan size in UK £
Micro Finance	5200
Small Business	28000
Social Enterprise	50000
Individuals	500
Average Loan	**20925**

(Source: CDFA, 2005: 3)

Table 4.8: Lending by type of company, UK CDFIs, 2004

Percentage of Market size by Sector	% (of value)	£	No of loans
Micro enterprise	25.2	11,467,985	2271
Small enterprise	7.8	3,556,229	191
Medium enterprise	9.5	4,328,629	26
Loans to Individual	2.7	1,214,943	2719
Social enterprise	54.7	24,874,895	305

(Source: CDFA, 2005:23)

Table 4.9: Markets Served by UK CDFIs

Markets Served	No of CDFIs
M	11
SME	8
M/SME	8
M/SME /SE	6
SE	6
Support	5
SME/SE	4
M/SE	3
P/M	3
M/SME/Support	2
P/M/ SME/H	2
P/M/Support	2
SE/Support	2
VC/SME	2
M/H/SE	2
M/ SME/SE/Support	1
M/Support	1
P/H	1
P/M/H	1
P/M/SE	1
P/M/ SME/SE	1
SE/H/SME	1
SME/H	1
SME/SE/VC	1
VC	1
VC/SE	1
W/SE/M	1
W/VC/SE/SME	1
Wholesale	1
Total No of CDFIs	**80**

Key
SE- Social Enterprise
SME- Small and Medium Enterprise
P- Personal
M- Micro enterprise
VC- Venture Capital
H- Housing

(Source: Own research)

Between 2003 and 2005, UK CDFIs have created and/or preserved 95,000 jobs and are providing finance to nearly 10,000 businesses (CDFA, 2005). Many UK CDFIs are in a period of growth and despite the emergence of a number of new CDFIs, the sector is beginning to strengthen and mature (CDFA, 2005). As a result, CDFIs are continuing to diversify their operations by experimenting with new products, and/or offering services in new geographical areas (CDFA, 2005; Cook, 2005). To date, CDFIs have provided over:

> '£147,000,000 in loans and investments- a 40% growth in portfolios on 2003… [and have]… £400,000,000 available to lend and invest representing an 80% growth on 2003' (CDFA, 2005:2).

The UK Policy Context

In 1999, PAT 3 produced the report 'Enterprise and Social Exclusion' (NSFNR, 1999) to discover how to stimulate business enterprise and principally sustainable enterprise in deprived areas of the UK (NSFNR, 1999). The key finding of the report was that SMEs in disadvantaged areas faced considerable barriers when accessing finance for those firms wishing to start-up or develop their businesses. Therefore the PAT 3 strategy was to provide:

> 'A. Better access to services: people in deprived areas need better access to services that will help businesses succeed. This means improving business support and finance.
>
> B. Removing barriers to enterprise: there are unnecessary barriers that stop people from moving into self-employment and prevent some types of businesses succeeding. These need to be removed.
>
> C. More effective institutions: Central, regional and local government all have key roles to play in regeneration. So does the private sector in its own long term self-interest. These parties need to work better together and to have a stronger sense of shared objectives' (Original format, NSFNR, 1999:32).

With Government backing, CDFIs, as the revolving loan funds became labelled, were promoted as lenders of last resort with the aim of bridging the funding gap being experienced by SMEs in areas of high deprivation. The PAT 3 report stated that those who live in deprived areas lack access to finance due to an absence of collateral, thus mainstream financial institutions are reluctant to lend small amounts due to high costs in the lending process and the high risk of sanctioning finance to businesses located in deprived areas (NSFNR, 1999). So with the support of the *Department for Trade and Industry's* (DTI) SBS, RDAs, *Business Link*, and the private sector, CDFIs emerged with the aim of bridging the funding gap being experienced by enterprise and individuals (NSFNR, 1999).

The UK Government is also working towards increasing the level of financial literacy and poverty alleviation through community empowerment. The Government is promoting self-employment (Mosley and Steel, 2004) as a means of fulfilling its aim of reaching 80% employment levels by 2007 (HMT, 2005b). New Labour's concern for social justice and subsequent financial inclusion policies were inspired by the US Clinton administration's 'Third Way' which considered financial inclusion as a means of encouraging enterprise and increasing competition to create a new active, participatory welfare system (Giddens, 1998; Marshall, 2004). CDFIs are perceived by the state to be a financial vehicle to reduce welfare payments and to stimulate regeneration in deprived areas. In sum, the Government set out the case for CDFIs in that 'loans not grants' were seen as an alternative to giving those living and working in deprived areas an incentive to adopt a more entrepreneurial outlook (NSFNR, 1999:4) and shifting dependency away from welfare benefits to be replaced by access to credit that would encourage enterprise and opportunity in deprived areas (HMT, 2004).

Community Development Finance Association (CDFA)

In the UK, the CDFI market is underdeveloped compared to the US, yet with the creation of the CDFA in 2002 the UK CDFI sector was expected to strengthen and grow. The CDFA was established as a result of the UK Government's *Social Investment Task Force* (SITF) report '*Enterprising Communities: Wealth beyond Welfare*' (SITF, 2000). Thus, the CDFA was designed specifically for the movement by existing CDFIs. The CDFA currently represents 95% of the UK CDFIs (CDFA, 2005:61). The CDFA's role is to coordinate and strengthen the CDFI sector further by encouraging growth, diversity, performance which it does through providing training events, annual conferences, and networking opportunities for its members and supporters. In addition, the CDFA influences policy through developing funding opportunities and legislative frameworks as well as acting as the voice of the sector.

The CDFA's strategy is to develop 'a thriving community development finance sector' and 'to promote and strengthen the CDFI sector by supporting its growth and influence, enhancing its capacity to deliver and advocating on its behalf' (CDFA, 2004b:1). The CDFA is working towards a common ground for its members and supporters, one element of which is to set benchmarks and standards. In doing so, the CDFI sector can reflect on its performance and assess its influence on society. By setting performance indicators and targets, a CDFI can begin to measure its effectiveness and use that measure to attract fresh and additional investment and investors. Collin *et al*. (2001) argues that for UK CDFIs to develop, performance and accountability are key to sustainability. As evident in consecutive annual surveys by the CDFA, some CDFIs are reluctant to share information and performance with the rest of the sector (CDFA, 2004c, 2005). This could be a result of the competitive bidding process for funding from UK and European sources. In addition, older CDFIs are not separated from young CDFIs which hides the development process of CDFIs and makes the CDFAs data inaccurate. This also reflects the diversity and competitive nature of the sector despite many CDFIs targeting specific geographical areas with no other competitors.

Support for UK CDFIs

CDFIs are funded through a variety of public and private funding sources. European funds, Government, RDAs, Local Authorities, Business Link, Banks, trusts and foundations could contribute to CDFI activity in the UK. To ensure that new CDFIs were created and existing operations developed, public funding was essential. The argument for creating the Phoenix Fund was to tackle market imperfections, increase access to finance for enterprise and address the wider social and economic issues in disadvantaged areas (GHK, 2004). CDFIs are designed to fulfil a double or triple bottom line of economic, social and/or environmental objectives; combined this is a high risk operational model and focuses on financial exclusion. The Government set out the policy framework and the financial support which offsets the risk carried by CDFIs so that they could viably lend to low and moderate income people. The Phoenix Fund was controlled by the SBS. The Phoenix Fund subsidized CDFI operations and loan funds through grant funding. The Phoenix Fund established two types of funding for CDFIs to bid for, revenue and capital and CDFIs were able to bid for this funding. The application process did not require CDFIs to complete a standard form. Instead applicants were assessed on the potential to reach excluded target groups, the adoption of innovative approaches, best practice within the growing sector, potential or actual commercial viability, and they had to be able to provide measurable outcomes of their activity. In its existence:

> ‘The Phoenix Fund held [three] bidding rounds between 2000 and 2003, with the final successful applicants being announced in spring 2004. As a result the Phoenix Fund supports over 60 CDFIs, providing them with support in excess of £42 million’ (SBS, 2005:1).

The majority of UK CDFIs were established post 1999 when the PAT 3 report was produced and the Phoenix Fund was launched. Without the Phoenix Fund 30 CDFIs would not be in operation (GHK, 2004; Ramsden, 2005). Another perspective is that the CDFIs formed in response to the Phoenix funding may simply be short-term policy responses. In a study for *Advantage West Midlands* (AWM), Deloitte and Touche (2002) have argued that the Phoenix Fund alone could not address all the financial requirements of enterprise in disadvantaged areas. For example, business support also needed to be administered alongside the loans. An impact study of the Phoenix Fund revealed that in nearly half of eighty projects that had received support, 40% of all their operations and revenue costs were provided by the fund (Ramsden, 2005). With the loss of the fund due to a shift in Government policy towards personal finance, a considerable funding gap for CDFIs has developed. Those CDFIs that are dependent on the Phoenix Fund may be highly unstable, especially if they are unable to attract new sources of private funding to replace the public funds. UK CDFIs that existed prior to the Phoenix Fund have become more viable in the long-term as a consequence of the Phoenix Fund as they have developed their operations and built up their loan portfolio as the Phoenix Funds acted as a guarantee fund for defaulted loans.

In April 2006, the UK Government transferred responsibility for the Phoenix Fund from the SBS to RDAs as part of the Government's plans for devolution (CDFA, 2004b). Yet reports by GHK (2004) and Ramsden (2005) both reveal that a significant proportion of CDFIs remain dependent upon Government support despite the ending of the Phoenix Fund. Many CDFIs have not reached sufficient scale and maturity to be independent of external funding. In addition, many CDFIs have not planned for the long-term or sought alternative sources of funding for them to continue operating. Younger CDFIs that have not reached their target market or attained a certain level of viability could face an uncertain future. Mayo *et al*. (1998:47) predicted that RDAs could 'oversee the provision of technical assistance, the disbursal of guarantees and support for partnerships'. Thus, it was expected that RDAs would take on the role of the SBS (Ramsden, 2005), yet the only RDA to have developed a fund specifically for CDFIs is AWM. This is because CDFIs within the West Midlands and AWM have worked in partnership to develop a strategy of CDFI support for the region and lobbied AWM for the continued support of CDFIs. As AWMs fund for CDFIs only supports funding for SMEs (up to £50,000) a finance gap may be developing in the region for micro-enterprise (businesses with 0-9 employees)[19].

Another UK Government initiative for supporting CDFI activity is *Community Investment Tax Relief* (CITR). The CITR was introduced in 2002 by SITF with a mission

[19] AWM's Advantage Small Loan programme (ASLP) initially was unable to support micro loan finance providers up to £10,000.

to help bridge the gap between finance for regeneration on a commercial basis and the support from Government to facilitate enterprise as a means for regenerating deprived areas. Under this scheme investors get tax relief which encourages them to lend to CDFIs (including bank loans), also the CDFI can access loans at a lower rate of interest. To become CITR accredited, a CDFI has to show that 'the promotion of enterprise, economic development and social inclusion in disadvantaged communities [is] its main goal', have a proven track record and have 'viable plans for long-term sustainability' (HMT, 2001:14). To date, only £38 million has been invested in CITR. When Sir Ronald Cohen launched the scheme in 2002, it was envisaged that £1bn worth of investment would be made in four years. In 2006, two of the main providers of CITR have halted their programmes owing to problems with the administration of the scheme, thus the impact of CITR has been poor (Connon, 2006). CITR has, evidently, suffered internal constraints which need to be rectified as soon as possible. It was believed that the CITR could be an effective tool to strengthen the CDFI sector and shift CDFIs into the mainstream further by forcing them to work alongside financial institutions and business support agencies (GHK, 2004). CDFIs have been slow to take up the CITR, possibly due to the fact that they have to provide details of their track record; many CDFIs are still in their infancy and its difficult for a small, young organization to obtain this type of funding. As such, young CDFIs that have not built up a track record and are not investment ready, may face similar problems to those firms that they are trying to support.

Traditionally, the Bank of England oversaw the regulation of the banking industry (Marshall, 1994). However, the restructuring of the *Financial Services Act* in 1986 shifted UK financial services industry towards the more competitive US model where the selling of products and services was liberalized and the British banking industry became increasingly aggressive in its quest for profit (Leyshon and Thrift, 1994; Leyshon and Thrift, 1995). As a consequence there was a 'flight to quality' by the financial industry to the middle classes, excluding the poorer members of society (Leyshon and Thrift, 1994:268; Leyshon and Thrift, 1995:318). In 1997 as a way of addressing inequality in financial institutional activity, the New Labour government merged:

> 'financial regulation and supervision under a Financial Services Authority (FSA) with a purview that included supervision of banking, insurance and securities'
>
> (Marshall, 1994:255).

This change in policy streamlined regulation, as the FSA is answerable to the Treasury. This also makes it increasingly stable and transparent for financial institutions and the regulator. According to Marshall (2004), this also promotes financial inclusion within and between institutions through the development of partnerships between the Government and financial institutions. Thus, in this way, regulation through the Government is standardizing financial practices. It has been noted that a finance gap remains between CDFI and mainstream financial institutions and this has led to questions of whether a CRA for the UK is necessary (Collin *et al*. 2001; Marshall, 2004; Mayo *et al*. 1998; Palmer with Conaty, 2002). A UK CRA could make financial institutions engage further in CSR. Implementing the US CRA in the UK using a cookie cutter approach (or a one size fits all method) would probably not be effective as the 'British banking industry is well consolidated' (Mathiason, 2003:1) in addition to the UK's policy and institutional context which perhaps does not warrant a US CRA. A CRA would make banks serve excluded groups directly or indirectly via CDFIs, as Barclays bank, *Halifax/Bank of Scotland* (HBOS) and *Royal Bank of Scotland/NatWest* bank are already doing, and banks could be fined if they did not comply (Mathiason, 2003). But would the introduction of a UK CRA meet the needs of disadvantaged communities? How would it be regulated and what are the criteria for assessing those needs? The Bank of England monitored[20] banking activity in deprived areas for small businesses (BOE, 2000; 2002; 2004; Marshall, 2004). Alternatively, UK financial institutions need to become locally embedded like their US counterparts, so that public and private partnerships can synchronize their efforts in tackling financial exclusion. Marshall (2004:258) believes that the UK's example of financial institutions addressing financial exclusion is more 'coherently focused on the most disadvantaged and wider ranging than their US counterparts' which with 'a tradition of self-regulation and freedom from state interference is highly prized' makes introducing a CRA to the UK a challenging prospect. As the political system, banking regulation, culture and society remains different in the US, so it would not necessarily be wise to apply a cookie cutter approach to transfer the US CRA to the UK.

The Nature and Operations of UK CDFIs

CDFIs are continually adapting their operations to the market. Nevertheless, lending to those that are financially viable but excluded from mainstream finance is relatively high

[20] The SBS now monitors UK banking activity.

risk. As many CDFIs operate revolving loan funds, they rely on the loans being repaid on time and in full in order to on lend as well as cover revenue costs. In terms of impact, the CDFA acknowledges that CDFIs 'are working in unknown territory', as maintaining a balance between their financial and social objectives is a test of character in as much as that CDFIs are trying to identify and reach their target market whilst attempting to become sustainable (CDFA, 2004b:3). Although, according to the CDFA (2005), CDFIs are realizing their social objectives by reaching their target market through the level of loans sanctioned, number of jobs created and/or preserved, and the percentage of ethnic minorities, women and other excluded groups that CDFIs have served. However, there are other aspects that could be measured such as postcodes of employer and employees to determine whether those who live in deprived areas are being served by CDFIs.

As CDFIs depend on accessing funding provided by Government or not-for-profit foundation and other parties, they must be able to demonstrate their effectiveness. The CDFA annual survey includes data on financial performance which is defined as portfolio quality and risk, for example delinquency rate, defaults (net loan losses- net of any recoveries/gross loans outstanding which are also known as write offs), and income (CDFA, 2004a). In the 2004 CDFA annual survey delinquency rates averaged at nearly 9% and defaults fell from 2003 to just over 7% (CDFA, 2005:5). These figures are relatively low which reflects the youth of the sector. It is anticipated that the default rates will rise as the sector matures and CDFI clients become less able (or willing) to repay their loan (CDFA, 2005). This is because many small businesses have a high failure rate, especially young firms (Storey, 1994). Usually, when a business fails, repaying mainstream financial institutions takes precedence over CDFI loans. Loan interest rates vary according to each CDFI and the target market (SME/start-up/social enterprise) in which it operates. The average loan interest rate is over 16% (CDFA, 2005:30). Social enterprises have lower rates of interest which vary from 3% over base rate to over 9% fixed (CDFA, 2005:30). These lower rates of interest for social enterprises reflect the relatively secure nature of such loans and the source of funding for UK CDFIs to lend to this market. Moreover, the interest rate level depends on whether the CDFI charges fixed or variable rates of interest which fluctuate depending on the rate of inflation and the source of the capital that the CDFI has used for its loan fund. UK CDFIs can offer finance at rates that are higher than mainstream financial institutions as they are taking on additional risk as they are lenders of last resort, operate in disadvantaged communities and rarely have access to collateral to guarantee the loan.

In the 2005 budget, the Government shifted its focus towards personal finance (HMT, 2005a). With the loss of the Phoenix Fund project based micro-enterprise CDFIs may follow the policy and shift to the provision of personal finance. CDFIs are currently dividing personal and business finance into separate spheres, yet the two are interlinked and are often blurred by (potential) clients of CDFIs. This is especially the case for micro businesses, where the owners of the business often do not have separate bank accounts for their business and personal needs. In a study on the financial services utilized by US small firms, Bitler *et al*. (2001) considered that sources of personal finance are likely to be used in enterprise start-up stages or by those who cannot access mainstream finance. There is a danger that if the CDFI sector shifts towards personal finance, funding may not be available for such activity and the lending risks are greater. Given the longevity of credit unions, co-operatives and friendly societies in the UK these mechanisms may be better suited to providing savings and loans for personal consumption and home improvement whilst attempting to alleviate social exclusion and poverty (Fuller and Jonas, 2002).

Flow of Funds

The funding sources that a CDFI draws upon can impact on its organizational strategy. If CDFIs rely on public funds alone, then they have a short-term strategy as they must respond to the directives placed upon them by Government policy. However, a conflict arises when they must also try to conserve resources for the future. CDFIs may find that they need to recoup money lent during the first phase of operations before they can lend more money. This potentially makes a CDFI financially unsustainable. In comparison, if a CDFI has its own financial resources that are supplemented by public funds matched by additional private funding, then the focus shifts to the long-term and towards financial sustainability. If CDFIs have accessed a grant for their capital to on lend then it is effectively free money and the CDFI can absolve itself of the risk if the loan defaults as the grant funding underwrites the cost. More than half of CDFIs have an average fund size of £500,000 (CDFA, 2005:33). The loan funds can be leveraged by banks or guaranteed under the Phoenix Fund to offset the risk poised to CDFIs in their lending to near bankable businesses and individuals. It is ironic that the majority of CDFIs themselves are micro-enterprises or small firms with limited track records, security and credit histories. This can result in banks being reluctant to lend to CDFIs if they do not have the right credit history and loan book. Thus, CDFIs face similar challenges to those they are serving when accessing finance for their operations. As a result, a number of CDFI wholesalers have emerged such as BIG Invest, to serve CDFIs whilst they become sustainable and build a track record. For those CDFIs that can access a loan, social economy banks such as *Unity Trust Bank*, offer finance for CDFIs. In the future, with the demise of the Phoenix Fund, such borrowing will be vital in order for CDFIs to continue to operate. However, this facility will only be available to a minority of CDFIs as the funding needs to be matched by other private sources to reduce the risk of lending to CDFIs. The CDFIs also need to have a successful track record as they need to be able to demonstrate that they can repay the money borrowed. Owing to the markets they serve, CDFIs can be themselves relatively high risk enterprises.

Financial Literacy

CDFIs have a key role to play in addressing financial and business literacy through offering additional support or business advice to borrowers. Financial literacy is also part of CDFIs financial inclusion and poverty alleviation missions although not without added financial and policy support as this can undermine a CDFIs financial sustainability. Some UK CDFIs are managed by enterprise agencies and therefore operate in a different way to other CDFIs as they can access different funding sources and also provide business advice. As UK CDFIs employ an average of five full-time staff, they do not have the resources or capacity to support all clients needs (CDFA, 2005). According to Mayo *et al*. (1998:3) there remains a significant disparity ‘between the scale of the problem and capacity of the solutions’ available within the sector. Many CDFIs offer business advice in the form of assisting with business plans or making referrals alongside the loan process (CDFA, 2005). Yet this is another challenge for CDFIs as they manage, monitor and provide advice to their clients so that defaults are low, whilst balancing the costs of delivering support. CDFIs try to work in partnership with other business support agencies although the level, extent and effectiveness to which this occurs has not been measured. Networks of RDAs, local authorities, business support agencies, enterprise agencies, mainstream financial services, and private business support agencies work with CDFIs to act as a source of referrals, understand the community needs, and ensure excluded groups are being targeted and reached. CDFIs emphasize the importance of having regular contact with their clients in order to understand local market needs.

CDFIs rely on relationship banking and the business proposal to assess the viability of the loan which depends on a close relationship being developed between the CDFI loan officer and client. When dealing in emerging economies such as disadvantaged areas, tangible knowledge of a clients' business such as visiting the business premises and interviewing the owner of the enterprise is more relevant in assessing the viability of an application than using credit scoring techniques. Owing to the importance of local knowledge, UK CDFIs remain localized, despite a number of CDFIs operating at a national scale. A tension exists between becoming embedded within the local community and becoming sustainable that CDFIs need to address. If CDFIs become too large, there is a danger that they will lose focus and will not address the needs of a local community. Yet it is essential that CDFIs try to become self-sufficient in order to operate without Government subsidies as they tend to be short term. Sustainability only applies if the strategy of the CDFI is not to act as a policy tool. UK CDFIs focus upon finance for enterprise due to the strong belief by Government that small firms are the backbone of the UK economy and are an effective way of creating jobs and economic growth. As such, there is evidence to show that CDFIs that are embedded within private and public partnership networks are more dynamic and active (Bryson and Buttle, 2005). They are increasingly likely to innovate and experiment in different approaches to increase deal flow, investment and reduce default and loan failure.

Investment readiness is a key issue for firms accessing finance (Deloitte and Touche, 2002). Therefore, business support is vital in the loan process to get firms to coordinate their business plan and make business projections. As well as providing financial support, CDFIs can offer business advice as part of the application process. CDFIs either view business support as integral to the loan application, or as a separate issue and so refer clients to external agencies. Therefore, business support tends to be uneven within and between CDFIs (CDFA, 2005). CDFIs that offer more formal forms of business support to clients could have more successful businesses and as a result, have lower default rates than those CDFIs that do not offer business support. This also raises questions of sustainability for both CDFIs themselves and their clients. Organizations that offer financial and business support are often enterprise agencies that have diversified into offering finance to micro-enterprise and SME which include *Bolton Business Ventures* (BBV), *Lincolnshire Development*, and *East London Small Business Centre* (ELSBC).

Organizational strategy is about how CDFIs achieve their missions. However, there can be a disparity between a CDFIs strategy and its mission. A CDFIs mission and strategy are dependent upon how, why, where, and when it was established. Mission and strategy should both be strong factors in influencing CDFI operations. Yet, UK third phase policy driven organizations that were established in the 2000s, may have been set up rapidly without understanding the needs of the borrower, operations of a loan fund or the longer term strategies required to run a successful CDFI. This type of CDFI is largely dependent upon state funding and is thus exposed to enhanced levels of uncertainty.

Sustainability

Sustainability is a key issue for CDFIs as they have to maintain their operations through lending to those at the commercial margins and ensure that loans are repaid to demonstrate their validity and to finance their operations. There are three stages of sustainability: financial sustainability, operational sustainability and market place sustainability (Ainger *et al*. 2002). Financial sustainability is defined as the organization being able to cover its costs purely through its lending activities. Operational sustainability is where the organization can cover its revenue costs through earned income (Ainger *et al*. 2002). Market place sustainability is a short to medium term strategy to work towards operational sustainability. Sustainability is a major challenge for CDFIs as they have to fulfil a double bottom line. CDFIs aim to be financially sustainable but it is extremely unlikely that this will ever be the case for the majority of CDFIs. A more rational approach is for CDFIs to work towards operational sustainability. Few UK CDFIs are currently market place sustainable. This is because

CDFIs need to find a niche for fulfilling social objectives (Mayo and Mullineux, 2001) to serve market needs and in the long term, become sustainable. Collin *et al*. (2001) believe that a cultural shift is required for CDFIs to become sustainable at an operational level. Thus CDFIs need to lessen their dependency on public subsidies and rely on their own internal revolving loan fund for operational revenue and capital to on lend. This requires a CDFI to focus on the medium to long term strategy of their business and generate a number of external funding sources so that there is less risk of failure. It also implies that loans are made to lower risk clients in order to reduce default rates. In this way, CDFIs are not dissimilar to any other small businesses which have to be flexible, innovative and dynamic.

In essence, CDFIs face the same issues as other financial institutions in widening their own access to finance (Mayo *et al*. 1998). Thus, CDFIs must try to innovate and experiment with their application processes and lending techniques, organizational structure, funding for operational and revenue purposes, and knowledge of borrowers (Mayo *et al*. 1998). The difficulty is ensuring that they continue to reach their target markets and maintain a continuous deal flow whilst meeting both their social and financial objectives. In addition, CDFIs are also small firms and are undergoing similar processes that they encounter in their client.

Conclusions: US and UK CDFI Comparison

This chapter has explored one way in which relief from financial exclusion for enterprise is partly overcome through the operations of US and UK CDFIs working in marginalized communities. The US and UK have a long, complex history of financial exclusion. Marshall (2004) suggests that an effective direct comparison between the US and UK movement towards financial inclusion and CDFIs cannot be undertaken as the majority of UK initiatives are in the early stages of development compared to the US, work in different markets and have achieved different scales so it is difficult to assess their impacts. Moreover, the US has an explicit financial inclusion policy whereas the UK has a more complex web of partnerships and networks working in different ways and at different levels, thus making financial inclusion disparate. It is clear that CDFIs in the UK and US share the same fundamental aims. Yet the institutional context, lending focus (whether business or personal finance), scale of the CDFI operations (which impacts upon their lending capability), social and financial impact, dependence on external sources of funding and sustainability levels differ markedly. The US and UK CDFI sectors share similar Government financial support such as the CDFI Fund/Phoenix Fund, NMTC/CITR, SBA Guarantee Scheme/SFLGS, and both have a mix of top-down and bottom up approaches which balance institutional support and the key objectives of CDFIs. Yet Marshall (2004) and Mayo *et al*. (1998) would argue that the UK lacks the equivalent of the US CRA which forces banks to lend to underserved markets. Arguably, if this was introduced and successfully implemented in the UK, then CDFIs would continue to operate and banks would donate money to CDFIs. Yet the CRA in the US highlights the extent of the problem as the banks do not take on enough risk and this creates the funding gap that CDFIs are trying to fill.

US and UK CDFIs differ in their approach to lending. In the US, for example, there is a trend to lend only where security is available to guarantee the loan. Therefore, US CDFIs reduce risk levels compared to the UK. In the UK where start-ups are financed alongside established businesses, and there is also a shift away from the provision of business to personal finance which is high risk and security is only taken where available. It is not surprising that US CDFIs have experienced faster growth rates than their UK counterparts due to the size of their market and age.

The establishment and development of CDFIs is not a straightforward process and is a continuous challenge. This chapter has illustrated the nature of CDFI lending activity in the US and UK highlighting the opportunities and risk/reward ratio that needs to be balanced within the lending process. As a result of the diversity within CDFI markets and the tensions that exist within the business models, US and UK CDFIs could be classified as a 'hybrid' sector, constantly trying to balance their social and financial objectives. As Buttle (2005:223) suggested, some CDFIs could even be 'schizophrenic' in their approach, owing to the conflicting cultures of being a financial institution and a not-for-profit. It is this contradiction in the lending process that this research aims to investigate within and between CDFIs in the UK and US.

This chapter has discussed the key issues surrounding US and UK CDFIs. The overriding issue is the sustainability of CDFIs. The viability of CDFIs depends on their ability to follow the market and the funding opportunities accordingly. With the reduced funding and support from the US and UK Governments, the CDFI industry is facing challenging times. It is anticipated that for CDFIs to cut revenue costs of their operations, outsourcing, mergers, partnerships and network opportunities will be created and enhanced for them to survive. Community finance has evolved and shifted over time, so it is not surprising that CDFIs have to demonstrate their impacts and outcomes. This is especially important with many CDFIs in receipt of public subsidy. It is important to recognize that community finance initiatives were created in response to a gap in the market. Perhaps CDFIs now have to respond to other market gaps and seize new opportunities. In sum, CDFIs remain in a state of flux, are constantly evolving and are dynamic, fluid entities in order to reach their social and financial aims and achieve sustainability in the long term. Moreover, the inconsistent development of CDFIs within the US and UK is creating highly uneven geographies of finance which impact on the financially excluded.

CHAPTER 5 THE NATURE AND OPERATIONS OF US AND UK CDFI CASE STUDIES

The purpose of this chapter is to outline the nature and operations of US and UK CDFIs, using case studies from the two countries to highlight the different loan fund models which reflect the diversity and complexity of the CDFI sectors within them. The chapter begins by outlining how and why the CDFI case studies were established, the missions and role of CDFIs, the structure of the organizations and how and why CDFIs may have changed since their inception. The second part of the chapter explores the different markets[21] that the CDFI case studies serve, whilst the third part outlines the CDFI loan application process; from how clients are reached to the decision making process whereby loan applications are authorized or declined, and the monitoring of loans. The final part of the chapter explores the role of performance and how and why this is measured. In this way, this chapter reflects on the concepts and themes on enterprise and finance as outlined in the previous chapters.

The Pre-Loan Process

The operations of the US and UK CDFI case studies are defined by their missions, market, geographic area, products and services, such as business support and its organizational structure. The US and UK CDFI case studies vary according to how and why they were established, who they were established by and their missions, which defines their social and economic objectives. The key characteristics of the US CDFI case studies are highlighted in Table 5.1 and UK CDFIs in Table 5.2. The US and UK

[21] Market can be defined in terms of business sector and geographical area.

CDFI case studies were all loan funds with the exception of one CDFI which was a community development bank that had a loan fund as part of its operations and the UK CDFI are all loan funds.

US CDFI Case Studies

The US CDFI case study firms were established between 1973 and 1999 (Table 5.1). The US CDFIs developed loan funds for SMEs in response to finance being another facet of their missions, demand and/or a gap in market. Half of the US case studies began lending shortly after their inception. Three of the six US CDFIs in this research only began offering loans to small businesses when Government support was available under President Clinton's CDFI Fund and only one US CDFI had been established since the introduction of Government support for CDFIs through the CDFI Fund in 1994. Although three CDFIs that had financed small businesses post-1994 when the CDFI fund was introduced, one US CDFI had only started operating in 1999. During the third phase of US CDFIs, one of the US CDFI case studies was initially developed from an organization that began by providing employment training and subsequently began to provide loans. Another CDFI that emerged in the third phase began its loan fund before opening its business support centre. US CDFIs were established in response to the changing banking environment in the 1980s and 1990s (Barr, 2005; DeYoung *et al*. 2004; Dymski and Veitch, 1996; Leyshon and Thrift, 1994, 1995, 1997). The CRA also played an important role in encouraging CDFI development and formulation. In addition, half of the US CDFIs did not operate in small business lending markets until they had support from the CDFI Fund which strengthened the sector (Pinsky, 1995). Without Government subsidy, the risks of lending to small businesses were too great or small business lending was not a market that they had fully developed and so was not part of their original missions.

Table 5.1: US CDFI Case Studies

US CDFI	Case Study 1	Case Study 2	Case Study 3	Case Study 4	Case Study 5	Case Study 6
Year Established	1986	1985	1992	1991	1999	1973
Year small business loans established	2001	1998	1992	1991	1999	1973
Geographical area served	City	Sub-region	Sub-region	City	City	Sub-National
Markets served	M, C, SME, VC, P	E, H, C, VC, SME	H, SME, C, M	M	SME, C	M, SME, VC, C
Total lent to SMEs	$23 m	Unknown	$4 m	$40 m	$2.6m	$62m
Interest rate	1%	9.5%	7-11%	10-18%	Variable	Variable
Default rate	9%	10-15%	3%	5%	30%	Unknown
Other services	Workforce training Technical assistance	Technical assistance	Technical assistance	Technical assistance	Technical assistance	Technical assistance, Advisory services
Loan size	SME $500-$100,000, C $100,000-$1,000,000 NMTC $1,000,000+	SME $25,000-$750,000, C $50,000-$2,000,000	M less than $15,000, SME $35,000-$100,000, H $200,000-$300,000	M $500-$50,000	Start-up $5,000 and less, SME $25,000-$250,000	unknown

(Source: Own research)

Table 5.2: UK CDFI Case Studies

UK CDFI	Case Study 7	Case Study 8	Case Study 9	Case Study 10	Case Study 11
Year Established	1996	1993	1983	2001	1998
Year M/SME loans established	1997	1993	1985	2001	2000
Geographical area served	City	Sub-Region	Sub-Region	Sub-Region	Sub-Region
Markets served	SME, SE	M, SME, SE	M, SME, SE	M, SME, SE	M, P, HI
Total lent to SMEs	£4.67m	£5m	£3.9m	£2m	£1.6m
Interest rate	12% SME, 4% SE	12.5%	12.5%	19%	22-24%
Default rate	22%	12%	15%	8.4%	8%
Other services	Business support		Business support, business mentors, business space		Financial advice
Loan size	£10,000-£50,000	£1000-£20,000	£500-£30,000	£250-£30,000	Up to £5000
No of Jobs created and/or preserved	2310	2126	1420	835	220
No of loans authorized	321	500	570	208	1900

Key
Loan Sectors:
C- Community
E- Energy
H-Housing
HI- Home Improvement
M- Micro
P- Personal Consumption
S- Small Business
VC- Venture Capital

(Source: Own research)

UK CDFI Case Studies

The UK CDFI case studies were founded between 1983 and 2001 which, compared to the US CDFIs, is a decade later than the first US CDFI case study (Table 5.2). Two of the UK CDFIs launched in the same year that they began lending, one of which was created in response to the introduction of the Phoenix Fund (Table 5.2). The remaining three UK CDFIs, one UK CDFI began as an enterprise agency which offered business advice and later added loan finance to its operations. The UK CDFI in question started its loan fund in 1985 for micro and small businesses as a lender of last resort. It found that clients were rejected by banks for finance as they had no collateral or savings. This UK CDFI case study also provides its clients with a business incubation service in terms of work space, finance and advice, and continues to operate by attempting to fill market gaps. The Chief Executive at this particular CDFI believed that CDFI operations are about plugging gaps that the private sector has not filled. Two other UK CDFIs were founded and launched in the same year (1993 and 2001). Four of the UK CDFIs were launched prior to Government support being available for CDFIs under the Phoenix Fund. One UK CDFI stated that initially they raised funds from mainly private sources and in 1999:

> '[Our CDFI] then moved into the Phoenix Fund because the Labour Government in particular had an interest in the CDFI sector in the [United] States' (8a, UK, 13.01.06).

It is worth noting that all the UK CDFIs (with the exception of the former enterprise agency) classified themselves as CDFIs. In contrast to the US CDFIs, three of the UK CDFI case studies were instigated by local authorities or local enterprise agencies. Similar to the US, two UK case studies were founded by visionaries, inspired by the US

CDFI industry who then worked with a team of individuals who had experience of lending that could transform the ideas into reality. Therefore, the US Government's third way agenda suggests that the financial system is shifting towards alternative forms of finance for both individuals and businesses (Giddens, 1998). Amin *et al*. (1999) suggests that the social economy, which includes CDFIs, moves between the state and the market which shifts the risk from state responsibility to the local community. On this basis, the UK and US CDFIs were viewed as an alternative model of finance for those individuals who had been unable to access finance from mainstream institutions (Leyshon *et al*. 2003).

The US CDFI case studies were originally established by altruistic individuals and/or groups to create wealth in deprived areas and with the aim of regenerating those areas. The backgrounds of the founders included social work or running their own small business who had witnessed and/or experienced difficulty in accessing finance as a result of discrimination, redlining and other forms of financial exclusion. The primary mission of all the US CDFI case studies was to create jobs, wealth, and opportunity in disadvantaged areas (NEF and Nicholson, 2003). One US CDFI noted that:

> 'lending [to] small businesses…to create jobs,…its very much within our mission, its just yet another vehicle to provide jobs to low skilled employees and develop neighbourhoods'/economic development' (1a, US, 07.10.05).

Another US CDFI stated:

> '[Our] mission is to provide financing and training to people who lack access to traditional sources of credit and so…in our mission we don't

> make a distinction between where they come from, what type of business they have, but it turns out that the majority of people in that situation are minority or immigrants' (4a, US, 17.10.05).

US and UK CDFIs aim of creating wealth and opportunity in disadvantaged areas was not fully realized until they began lending to small businesses with or without the support of the CDFI Fund. Small firms play a fundamental role in the economy, particularly their potential for creating employment, opportunity and wealth (Acs and Storey, 2004; BOE, 2000; Cressy, 2002; Keeble, 1997; Martin, 1999; Mayo *et al*. 1998; Porter, 1990; Storey, 1994). The missions of UK CDFIs are similar to those of US CDFIs in that they endeavour 'to improve the prosperity of the people living within our communities' (13a, UK, 27.06.06) by providing loan finance. In sum, the raison d'etre of US and UK CDFIs was to create 'economic wealth' (9a, UK, 10.02.06) in deprived areas:

> 'the people…[in the local community]…said they wanted a link between the banks and building societies which were flying out of the area because of lack of business... There was very little in the way of economic activity going on and many of the shops were shutting and it was becoming a drug and [an] economic ruin area' (8a, UK, 13.01.06).

The creation of wealth through enterprise is key to the future success of deprived areas (Porter, 1990).

At the start of their operations, each of the US and UK CDFIs identified particular groups that suffer from financial exclusion and have targeted their operations to serve their needs, for example, women owned businesses, and minority ethnic businesses (NEF and

Nicholson, 2003). But by serving one section of the community, the market is not large enough to sustain CDFI operations. The following demonstrates why one US CDFI case study was established and how it has developed since its inception in the early 1990s:

> 'The organization was founded by the African-American community…[who] realized that there was an issue of access to capital…[However] it was really hard to…build a high quality organization just serving one segment of the population. So the idea was then [that] we would expand into other communities…that had similar issues. But even that was not gonna provide the economies that we wanted so what we said was … 'why not serve the whole market place' cos we understood that there was [sic] issues of access to capital even in rural areas, or even in non persons of colour, there was still issues of access to capital so why don't we, if were gonna have staff available and management available why don't we offer this to the whole market place?' (3a, US, 13.10.05).

This attitude also reflects the tension in creating an organization that has to balance and maintain its original missions with the aim of becoming financially sustainable in the long term (NEF and Nicholson, 2003). In contrast, according to one US case study, it has remained true to its original core values since its inception in the 1970s:

> 'I think that probably three things that have stayed the same. One is the concept of entrepreneurial energy,...the second thing is that there is value in the regulated commercial bank model, and the values come in a number of ways but in a big way the major one is the ability to go to scale, but

> there are lots of pieces of that, some of which relate to being regulated. [The] third point which is that [the organization] always had this notion that while the commercial bank was a really important financial engine, it couldn't do it itself and that…job training [is essential when lending to small businesses in partnership with other locally based organizations]' (7a, US, 07.03.06).

Yet this US CDFI has the advantage of operating as a bank which allows it to use depositor's funds for its lending activity as opposed to relying on grants from the public sector.

Markets Served

US CDFIs offer finance to affordable housing projects, energy saving and sustainable energy projects, SMEs, emergency personal finance and equity finance (Table 5.1). The diverse range of markets is a result of the finance gap for individuals, businesses, social enterprises, hospitals and schools in underserved communities. The size of loans range from $300 to $5 million (Table 5.1). The size of SME loans range from $500-750,000 (Table 5.1). US CDFIs offer equity finance, working capital, emergency finance, finance for start-up and existing businesses, revitalization of housing/community projects, personal consumption and energy conservation (Table 5.1). UK CDFIs provide finance to micro enterprises, SMEs, social enterprises and to a lesser extent, home improvement and personal consumption (CDFA, 2004). UK CDFIs emphasize the significance of finance for enterprise as a result of the Labour Government initiative and the existence of the welfare state. The size of loans varies according to the markets that they serve. The

UK CDFIs offer finance between £250 and £50,000. The average loan made by UK CDFIs is £10,000.

The majority of US lending portfolios comprise housing and/or community projects which are secured by real estate and are, therefore, low risk. The portfolio is then balanced with higher risk lending such that:

> 'the reason why we do non-profits is they create community impact and they provide a community service and a lot of times they have…problems with access to capital so we lend to them…so all those [loans] in the housing and non-profits subsidize the small business lending, micro lending that we do, because we have yet in 12 years, never written off a housing or non-profit loan, so that's again a whole subsidy notion' (3a, US, 13.10.05).

The business and personal lending is largely secured by guarantee which in this case can be a personal guarantee or secured through the US CDFI putting a lien on property or equipment:

> 'security…could be in the form of a personal co-signer or separate personal guarantee and then also cars or whatever sort of machinery in collateral and…an all asset lien …on the business saying that if for some reason you do not pay, we can claim up to this amount...We don't do that for everybody, again it's a matter of [if] they're more formal or the larger loan amount then something like that might happen' (4b, US, 17.10.05).

In this way, US CDFIs are lowering the default risk of loans. By balancing high risk markets with lower risk markets, US CDFIs are acting in the same way as mainstream banks. However, it is important to note that US CDFIs are not lenders of last resort and so are on occasion, providing loans to bankable businesses. Similar to the US, the majority of the UK CDFI case studies offer finance for social enterprises as well as for-profit enterprise. The reason for this is to balance the higher risk of lending to for-profit businesses with the lower risk social enterprise market. The markets may seem simpler compared to the US, however, according to all but one UK CDFI, a very small percentage of UK CDFIs can successfully lend to social enterprises as social enterprises are risk averse and as grants are available, they would prefer to take the cheaper and safer option. However, US CDFIs have a greater size of funds and their lending activity is dominated by secured housing loans. UK CDFIs have had to balance their portfolios more carefully than those in the US. Moreover, UK CDFIs do not take collateral to secure the loan and there an ethical question in relation to clients securing loans against their home (if they own a property in the first place) and the loan defaults, is it right to make a family homeless? As such, it could be interpreted that UK CDFIs balance their social objectives with their economic objectives.

The geographic area served by US CDFIs ranges from City wide to sub-national where CDFIs operate in a number of different States across the US. City wide CDFIs are still large organizations that tend to have a number of offices and/or loan officers located around the city. The sub-national CDFIs take a similar approach so that local knowledge is used to the greatest effect. As such, US CDFIs mainly operate in urban areas which have the greatest areas of deprivation. On the basis of the CRA, CDFIs operate in markets that are underserved by mainstream financial institutions (Barr, 2005; Leyshon and Thrift, 1994, 1995, 1997; Marshall, 2004, Mayo *et al*. 1998). However, one US CDFI discussed working in ‘emerging markets’ (2h, US, 11.10.05) as it is not necessarily the best decision to move into markets that need the most help. This US CDFI stated that these emerging markets are located at the frontier of the disadvantaged areas and consequently they are ignoring truly disadvantaged areas to reduce lending risk. In this way, some CDFIs are operating as banks have done historically through redlining areas that are perceived to be high risk. As CDFIs strategically target ‘emerging markets’ rather than deprived markets, and are thus acting as complementary to mainstream financial activity. Through previous bad experience, CDFIs are not working in truly deprived markets and are not taking on higher risks associated with small business lending even when balanced in other markets. Therefore, US CDFIs are relatively risk averse. Instead they are hoping that by working on the frontiers of disadvantaged areas and in making the area more competitive, new jobs will be created through knowledge spillovers (Acs and Varga, 2004).

The geographic area served by UK CDFIs is at a city and sub-regional scale. Operating at a local level has meant that there is deep knowledge of the local area. This has allowed CDFIs to become embedded within the locality and to meet the needs of the clients by having a close working relationship with them. These findings match those of the UK Department for Communities and Local Government (DCLG, 2006:38) which states that Government policies have a greater chance of success if they are embedded in the communities which they serve as they have to build networks of trust and have the 'flexibility to adapt to specific local conditions'.

The current geographic coverage of CDFIs in the UK is uneven and so there is potential for growth in the future, either through mergers or takeover of areas from less successful CDFIs. Some CDFI funding is restricted to local 'transitional areas' which are defined by postcode:

> 'In terms of our defaults there's a big problem because pretty much all of our defaults are in the poorer areas and hardly any defaults are in the transitional areas but the problem is that our money is split 70/30 and you can't transfer between the two. So you need to keep an eye on everything' (9c, UK, 10.02.06).

Clearly there is tension in lending to the transitional areas and the high risk associated to these markets whilst aiming to become financially sustainable in the long term. Yet it is the role of the CDFI to balance this conflict of interests by using local knowledge, partnerships with the community and the experience of staff. Also, the use of the term 'transitional area' is similar to the use of 'emerging markets' in the US.

Operational Structure

The scale of CDFIs varies widely, especially between the US and UK. CDFIs in the US are significantly larger than their UK counterparts. The smallest UK CDFI has 5 full-time staff whilst the largest CDFI in the US has over 60 full-time employees. One UK CDFI employs 8 full-time employees and 25 self-employed business advisors. In this way, the CDFI is reducing its costs and therefore the risk. These figures do not include board members which provide their services on a voluntary basis. Three UK CDFIs employ one person specifically to monitor and manage the clients in terms of repayment and defaults. In the US, there is a clear operational structure to the CDFIs and:

> '[by having separate departments] it keeps everything more efficient. The loan consultants[22] know that they are, [and] will always be the primary contact for a client whether or not its dispersed or not' (4b, US, 17.10.05).

Two UK CDFIs monitor their clients with the support of their back office which notifies the CDFI of any issues that may arise when repayments are due. The CDFI lending team then deals with the clients, which could have negative implications due to the embeddedness of the client/loan officer relations. The average number of loan officers at each UK CDFI is two. In the US, the average is 12, plus administration and support staff, technical assistance providers and so on. These figures are not surprising given the size of the geographical areas and different markets that the UK and US CDFIs serve. Nevertheless, US and UK CDFIs are working on tight operational budgets and time frames. In this way, the loan due diligence and monitoring process could be compromised as a result of staff being overstretched.

Since their inception US and UK CDFIs have become increasingly professional in their operations**.** One US CDFI described the development of the organization:

> 'when I first started at [the organization] it was just me and an administrative assistant and the first person I hired,…I really couldn't

[22] In the US, loan officers are known as loan consultants. Generally, the US loan officers are employed by the CDFIs but can be independent and self-employed.

> attract lenders or people with financial background because who wanted to come work for a really small organization and we couldn’t afford a person with business lending experience so we hired a person that had more of an economic development or social service background and then because I was a banker, I tried to teach them all the lending aspects, the lending culture, it was really a slow go because they had the mission part but it takes years and years to develop a lending culture or really develop lending experience. So eventually I embarked on a strategy to hire…former bankers that had a commercial lending background and then I had to [teach] them the mission part, we found that was much easier…to bring in new people lets say with a college degree didn’t have any lending experience cos we already had established a culture of lending…I think a lot of CDFIs when they start off they tend not to hire the lending type, they tend to hire the social service type that have the mission piece and then try to learn the lending, they really struggle I know we did in our early years we struggled that way too’ (3a, US, 13.10.05).

The strategic shift of hiring staff with banking experience rather than a social background indicates that there was a need to create an increasingly professional industry to enhance their operations (Emerson, 2003). In doing so, CDFIs are creating a corporate culture that is informed by their strategy, whereby staff have shared values and their behaviour can reflect the values of the firm (Schoenberger, 1997). By hiring ex-banking employees, CDFIs are continuing the orthodox banking approach to create an increasingly professional sector.

The move towards a more formal, mainstream approach suggests that CDFIs are formalizing their activity by taking a more considered approach with regard to funding and lending practices. In this way, it appears that increasingly US CDFI practices are formalized as a survival mechanism:

> 'I hope for it to survive as a genre, they need to commit to bigger funds that sustain themselves. Ours is one of the biggest in the market, there is only one other that's on our scale or two others I think many of them are way too small so you can create sufficient diversity and they can't manage themselves financially, they don't have any staying power in the market. I mean there's just so many issues so I'm hoping when liquidity comes into the market I don't know that that will happen but if that happens then you know they can afford and should you know should bring in more professional management' (2e, US, 11.10.05).

CDFIs need to take risks in order to attract and access a range of funding streams so that they can grow and diversify their markets. With reference to US CDFI staff one US CDFI states:

> 'It's been an amateurs market and that's not good you know … good people need to be paid, need to be incentivized just like they were in any other part of the market. In fact, arguably I mean I don't say this for myself personally, but arguably in some respects its harder than any other part of the market because you've got two objectives and so you know the pay scales have to address that issue and there has to be quality or there is no point in doing it. So are we headed there, I feel like [our organization's]

> done that. We have just terrific seasoned experienced staff that really knows what they're doing and are supported by their strong workforce. We're really pioneers in that respect, so I feel really good about that. Now that doesn't mean were gonna succeed by the way, but at least it means that we have given our investors the right formula in my opinion for creating a successful platform' (2e, US, 11.10.05).

Employment of staff from the banking sector ensures that there is formal banking knowledge to draw from, but also can cause problems as banking professionals need to be re-educated so that they evaluate loan applications in a different way. US CDFIs have to balance getting the appropriate staff and level of earnings in line with their missions which is also an issue for all the UK CDFI case studies.

Mainstream financial institutions are risk averse and potential customers that are located in geographically deprived areas are increasingly likely to be refused credit (Leyshon and Thrift, 1994). Leyshon and Thrift (1995) state that financial institutions need to become locally embedded in order to understand the needs of borrowers. Bryson and Buttle (2005) suggest that UK CDLFs are alternative in that they are set up by social entrepreneurs. However, within US CDFIs and possibly to a lesser extent UK CDFIs, there has been a shift from being an alternative source of finance towards becoming more mainstream in their approach. As such, it could be understood that US and UK CDFIs have undergone a process of change through their development, where at the beginning they were alternative financial institutions, but they have developed into hybrid organizations which combine orthodox and alternative business models and processes to accomplish their objectives (Rose, 2000). The shift may have impacted upon their portfolio performance and ability to reach their target market as riskier deals are seen as not conducive to becoming financially sustainable. In the case of US CDFIs prefer to seek real estate based deals such as community and housing developments which fulfil both their social and financial objectives. Despite these deals being significant for the community, they are not creating long term employment opportunities.

The US and UK CDFI sectors have undergone a series of different phases, driven by Government funding support. The first phase of CDFIs was triggered by individuals recognizing the market gap for enterprise finance. The second phase was inspired by the success of the first which consequently led to Government support for the sector. The third phase of CDFIs are project based, largely established on the back of the available funding schemes. These are policy driven or more correctly Government programme driven organizations. US and UK CDFIs missions, regardless of when or how they were established, have remained constant and are based on the creation of jobs, wealth and opportunity in disadvantaged communities. In addition, the US CDFI markets are more sophisticated and diverse than their UK counterparts as US CDFI operations are larger and more complex. That is not to say that US CDFI are superior to UK CDFIs, but US CDFIs operate in a more competitive, yet financially supportive environment. However, the increasing professionalisation of the US CDFI sector has also made the sector increasingly risk averse which in turn is institutionalizing some US CDFIs into the mainstream. In sum, US and UK CDFIs have streamlined operations to remain efficient organizations. However, CDFIs are becoming increasingly professional and in doing so, there is increasing tension between CDFIs missions and their operations.

The Loan Application Process

This study undertook research at a large high street bank in the UK to explore the similarities and differences between the mainstream financial institution loan application process for enterprise and the alternative CDFI lending process.

The Lending Application Process in a UK Mainstream Financial Institution

UK high street bank lending begins with referrals made through local branches, existing customers or key business introducers, for example, accountants. If clients apply to the bank online and the application is straightforward, the loan can be assessed against standard criteria at an offshore call centre (which reduces the cost of the loan application and increases the bank's profit). If the application is complex then the loan is assessed in the UK at a centralized location. If clients contact the bank's local business manager, applications are made in a face-to-face meeting. There are no application forms, as all applicants are different; for example, sole traders, partnerships, limited companies. The meeting between lender and borrower takes around 45 minutes but this depends on the complexity of the application. Sole traders and partnerships can access up to £50,000 unsecured, but the interest rate is higher for unsecured loans. Local business managers can authorize these applications with the bank's credit team. Limited companies can access above £50,000 if there is security available to guarantee the loan. If they require more than £50,000, the national, centralized general lending team assesses the application and to do this require three years accounts plus expenditure and cash flow forecasts. The loan decision can be made within three hours. The interest rate, on average, is variable 4% over base plus a fee of 1.5%. The interest rate is fixed if the customer is high risk. Security against the loan is essential so that the customer can repay if the business fails. From this research, start-up businesses prefer to apply for overdrafts facilities as they think they will be rejected for a loan. As such, many people fear banks and think that banks are unapproachable. There is, therefore, a process of self-exclusion from enterprises accessing bank loan finance (Fraser, 2004).

Mainstream banks mitigate risk by allocating funds to each market, for example high risk, medium risk and low risk (Table 5.3). However, 80% of loans are made to low risk enterprises and high risk enterprises are supported with 50% matched funding by clients. At this particular high street bank, clients who miss one repayment and are unable to be contacted by telephone at their business or home are sent two letters with a formal demand to pay the remainder of the loan. If the client is unobtainable, the debt recovery unit takes over the case.

Table 5.3: UK Market Lending Risk

High Risk Markets	Medium Risk Markets	Low Risk Markets
• Engineering • Restaurants • Pubs	• Off licences • Play centres	• Old people's homes • Dentists • Doctors • Solicitors • Supermarkets

(Source: 14c, UK, 17.08.05)

The CDFI Loan Application Process

The CDFI loan application process is complex and differs with each application. The loan application process includes the following steps:

- referral to the CDFI by a mainstream bank, accountant, business introducer, word of mouth, etc;
- the borrower submits an application;
- the lending team assess the application in terms of due diligence and the risks/rewards of the loan; and
- setting the terms and conditions of the loan.

The CDFI loan monitoring process will be explored later in the chapter.

The CDFI loan application process begins with the referral process which often involves an introducer. This is followed by an assessment process in which applications are examined, in terms of their risk-reward ratio, as well as social and financial objectives and sustainability. The CDFI loan application process is dependent upon enterprises being investment ready. The investment issues faced by CDFIs are similar to mainstream financial institutions; adverse selection, information asymmetries and moral hazard. Adverse selection is where the owner of the small firm has distorted their capabilities and the investor cannot substantiate such claims until the deal has been completed. However, due diligence (a pre-deal analysis of the strengths and weaknesses of the project) is essential in assessing all potential investments so information asymmetries and moral hazard (selecting an unsuitable investment) can be reduced.

Referrals

In all the studies, potential clients were referred to US and UK CDFIs via networks of banks, local enterprise agencies, accountants, solicitors, word-of-mouth, in some cases other CDFIs and, to a lesser extent, through direct advertising. UK and US CDFI referral networks are largely determined by their funding sources, supporters and active networking. As such, CDFIs are dependent on both public and individual private institutions for both referrals and funding. However, the referral process from each institution varies widely for each CDFI and is largely dependent upon the goodwill of others as the referrals are made on an informal basis. Consequently, the efficiency of the referral network can be inadequate. In three of the US CDFI case studies, the deal flow (the number of potential clients) was an issue as banks at the time of the interview were approving an increasing number of loans to micro enterprises and small businesses. In the UK, two CDFIs noted that they struggled with a lack of deal flow and another three UK CDFIs said this was because CDFIs lack recognition within the community in general. Therefore, there is a low awareness of CDFIs within the communities that they serve, or perhaps a market does not exist, or needs to be developed via awareness development programmes (NEF and Nicholson, 2003). The lack of deal flow could be due to the social objectives of CDFIs. This has implications for both the lending process and survival of the CDFI. Moreover, local networks take time to develop and are then only temporary. If a CDFI fails to make links with the local community then they risk being isolated organizations which would undermine their viability and sustainability.

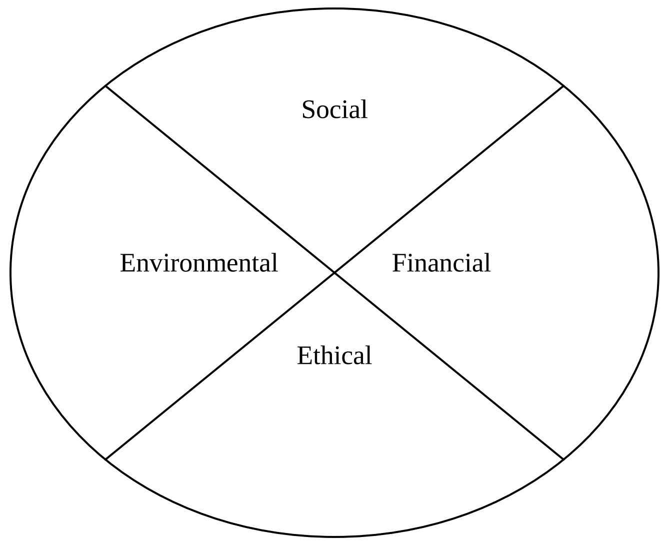
The key to creating a viable, sustainable CDFI is through balancing the loan portfolio. The UK CDFI loan application process is compared to a UK mainstream bank in Figure 5.4 then highlights the different approaches taken in decision making. The UK CDFI process includes; application submitted, assessment of social and financial criteria, market research, interview, due diligence, recommendation, decision and if successful, the loan is disbursed. In particular, it shows the interactions between those involved in the process and the time and places in which the decisions are made. The rapid decision making dialogue within the bank is streamlined and efficient due to the reliance on credit scoring. Also, at the UK bank, loan applications are generally made informally via telephone or internet rather than candidates making formal applications due to the reliance on computers. Efficiency and effectiveness and how they are defined are the key differences between banks and CDFIs lending processes, as CDFIs source funds from Government, not-for-profit foundations and banks they can afford to take higher risks as they receive grant and loan funding (Bryson and Buttle, 2005).

The CDFI loan application process is more detailed owing to their role as lenders of last resort and the number of people involved in making a decision on a loan. The first stage of the CDFI loan process is where the loan consultant assesses the loan application for any missing information, undertakes market research and a social and financial analysis of the loan application. The second stage of the process involves interviewing the applicant at their premises or, if a start-up business, at the CDFIs offices. This involves assessing the character of the borrower, whether their business is viable, if they have the ability to repay the loan, and also complete any missing information. If the applicant passes this stage then the third stage involves the lending team making a recommendation for a loan and setting the conditions. The final stage of the application is where the loan officer meets with the loan manager (if the application is for less than £20,000) or the lending team which is comprised of board members with knowledge of lending (if over £20,000). This is when the loan application is discussed according to the CDFIs social and economic objectives and assessed against the CDFIs loan portfolio. There are constant discussions by the lending committee that are ‘informed by experience and practice’ (Bryson and Buttle, 2005: 279). According to Bryson and Buttle (2005), there are two forms of discursive formations within the CDFI lending process. First, there is the ‘discursive formation of profitability’ where risks and rewards are played out to determine whether they can act in an ‘alternative discursive’ way so that the CDFI maximizes its own sustainability (Bryson and Buttle, 2005:279). Second, there is the ‘alternative discursive formation of value’ whereby profit values are replaced by values relating to overcoming financial exclusion (Bryson and Buttle, 2005:279). Alternative discursive lending decisions are based upon a CDFI making its lending decisions by balancing social, ethical, environmental and economic values (Figure 5.1). This includes 'social capital, the re-evaluation of environmental capital, local regeneration, the retention and creation of jobs for local people, and the financial obligations to ensure the [CDFIs] own long-term sustainability' (Bryson and Buttle, 2005:278). CDFI operations makes the lending decision relatively time-consuming especially when each individual within the lending team may have their own definition of what the CDFIs social and economic objectives are and whether or not a proposition is viable. As such, these discussions produce temporary balancing of a CDFIs social and financial objectives and in effect a case by case balancing:

> 'Each [CDFI] develops and modifies their lending through a set of social criteria or ideologies that limit lending activity to a specified target group of unbankable or near bankable borrowers' (Bryson and Buttle, 2005:279).

In this way, the lending criteria shifts with each loan application and is therefore a persistent source of tension as, in practice, it is difficult to separate alternative discursive profit and value. One UK CDFI questioned whether you can define social and economic objectives separately as they are inextricably linked (10a, UK, 03.05.06).

Figure 5.1: Chart to Show Factors in the CDFI Decision Making Process



(Source: Own research)

The CDFI loan process is fraught with difficulties and has yet to try to be as rigorous as possible. In this way, those involved in the loan dialogue are ultimately controlling the decision making and the CDFIs objectives. In awarding loans, banks aim to generate a profit whereas CDFIs aim to balance their social and financial objectives against the risk/reward ratio of the organization and generate a surplus to cover their overheads. The tension between the depth of reach and sustainability of a CDFI has to be balanced within each loan decision. This highlights the complexity and dynamism of CDFIs. The complexity of CDFI operations highlights the difficulty in measuring CDFI performance, particularly the social measures such as impact of the CDFI loan. Performance measurement is also time consuming and expensive, while many small CDFIs do not have the resources or skills for this activity. Ultimately, the tensions in the CDFI loan process questions the CDFIs management style and challenges the notion that a CDFI can become sustainable and balance revenue, loan income and portfolio against defaults. This explains why some CDFIs have become more commercial or policy led in their operations.

Table 5.4: Loan Decision Flow Chart of UK Mainstream Bank and UK CDFIs for SME Lending Activities

UK Mainstream Bank	UK CDFI
• **Day 1** Loan request (45 minutes) • Application details- years in business, Owner Occupation, Value of assets. If request is over £50k, also require 3 years accounts and forecasting expenditure and cash flow.	• **Day 1** Application Submitted with business plan, trading information (if applicable), bank account statements. • Social and Financial Criteria Assessed- number of jobs created/sustained, benefit to local community, environmental impact, investment ready.
• Recommendation made. • Up to £50k (unsecured) decision is made by an automated system. • Above £50k (secured) General Lending Team assess application (3 hours).	• Desk research, Market analysis. • **Approx Day 14** Interview- Character assessment (1-1.5 hours). • Further research/information gathered if necessary. • Due diligence. • Recommendation by Loan Manager. • Up to £20k (unsecured) decision made by loan consultant and Chief Executive. • Between £20k-50k (unsecured) Lending Team Assess Application.
• **Day 1/2** Decision- Loan Authorized/Declined. • **Day 2/3** Loan Dispersed.	• Decision- Loan Authorized/Declined. • **Day 28+** Loan dispersed. • Monitoring, delinquency management.

Note: Diagram shows decision making at different times and speeds. (Source: Own research)

All applicants for a CDFI loan have to complete a standard application form as well as submit a business plan and financial data such as banking statements. The application takes an average of four weeks to process in order to complete due diligence which involves the scrutiny of the application to overcome information asymmetries and reduce the risk of adverse selection and moral hazard (BOE, 2000; De Meza, 2002; Mayo *et al*. 1998; Storey, 1994):

> 'Due diligence is how we monitor the cases, especially prior [to] lending. Its very much [about] getting information. If it's a trading company due diligence is far easier, if it's a limited company you've got records, you've got accounts, you've got a track record and bank accounts, you've got the accountant you can speak to, due diligence from the customers, you can check all those out to an extent but you never foretell the future especially when some of the accounts are 12 months old. If you've got management accounts prepared in-house…[they] can be skewed to support a loan application which isn't justified and it does happen and has happened. Due diligence for a new client and a number of smaller clients are in simple sectors to be honest [as] they are not technical businesses [and] between us there is…lots of experience of banking over the years so if it's a day nursery, and engineering company, software designers, we tend to know roughly bits of that sector, desk research through Google, tracing competitors and Intel reports if it's a decent size so we try to do a lot of desk research, especially a lot of the due diligence goes into the person who is running the business we do personal credit searches, we'll check on

their registry if they say they own their own house we'll check it to see if they do, we'll find out how much the house was bought for so we do a lot of that stuff, the background checks on individuals as much as we can within the confinement we've got' (8c, UK, 10.01.06).

In all the CDFIs in the UK and US, a credit check is undertaken to verify details of the applicant and check the state of the applicants affairs so that any issues can be highlighted. In addition, a credit check also allows the CDFI to assess whether the applicant can afford to repay the loan. This is part of the social and ethical ethos of CDFI operations. In the UK, CDFIs also require applicants to submit a letter of decline from a bank. In the US, applicants do not need to do this as CDFIs are not lenders of last resort on the premise that banks do not lend to such high risk clients or not do provide small loans to firms, for example, loans less than $100,000 are not profitable (8h, UK, 05.06.06) (BOE, 2004; Rogaly *et al*. 1999; Van Osnabrugge, 2000). This is in spite of the CRA which requires mainstream financial institutions to provide products and services to underserved communities (Barr, 2005; Leyshon and Thrift, 1994, 1995, 1997; Marshall, 2004; Mayo *et al*. 1998). In this way, banks fund US CDFIs to take on this market so that they absolve themselves of the high risk of lending to disadvantaged communities and fulfil the requirements of the CRA.

CDFIs assess applications on character, cash flow, capacity to take on debt and commitment to repay the loan (NEF and Nicholson, 2003). In the context of an enterprise loan, two UK CDFIs stated that regardless of whether it is a social enterprise or for-profit enterprise, the loan application is assessed on the basis that the business is viable and has the potential for success as well as the ability for the loan to be repaid (BOE, 2000). According to one UK CDFI the enterprise application process requires:

> ‘a business plan and a cash flow forecast. They come in absolutely every range…from beautifully bound works of art that are probably not worth the paper they are printed on a lot of the time, to literally someone who has written out a business plan on the back of a cornflake packet, because I actually [say]…I just want your ideas as to what you’re gonna do, where you’re gonna do it, how you’re gonna do it and what the end result is going to be. So that actually the fact that they’ve had an input into producing a type of business plan, I’m not looking for formal works on it,…[then] take out a 2 hour interview [with the client]…So from there what I’m looking at is how they speak about what they’re going to do, you know their body language, how animated they are when I come to sort of put them through the mill about the cash flow when I sort of say ‘and is that how much you’re gonna earn’ if they can look me in the eye and say ‘yes’, I believe that’s what I’m gonna do, its all sorts of things that its, because 9 times out of 10 when they bring their cash flow in, their business plan in, I go well thank you for that you know, have a quick flick through and say well, you know, we’ll leave that aside for a minute, you tell me about it…and then I’ll go back and cross reference’ (13f, UK, 27.06.06).

The application processes for all CDFIs interviewed as part of the study were very similar and the only difference between US and UK CDFIs is the format of their application forms.

In comparison to CDFI lending practices, research undertaken at UK banks reveals that banks make lending decisions based upon credit scoring models and they do not usually require firms to complete an application form if they already have a business or personal account (Barr, 2005, BOE, 2000; Leyshon and Thrift, 1999, NEF and Nicholson, 2003). The majority of lending by mainstream financial institutions is based on quantitative information, such as credit scoring and it could be argued that banks' lending processes for smaller business loans are purely '*transaction-based*' (Cressy, 2002). According to one UK bank, character based lending is used by US and UK CDFIs and was previously utilized by banks until the introduction of credit scoring for relatively small loans (£50,000 and under) and the centralization of larger lending decisions (£50,000 and above). The research learned that UK banks do not decline many applications (due to unsecured lending for under £50,000 and the availability of the SFLGS, even though its effectiveness has been questioned) (Deloitte and Touche, 2002; Rogaly *et al*. 1999). In contrast to banks, UK and US CDFIs primarily base their decisions on character based lending and documentation. Character based lending is based on old banking practices (Barclays, 1987; Dyer, 1977):

> 'If you're familiar with banking they have what they call the five C's of credit, 5 C's and I'll try to say it, one is credit, number two is collateral, number three is character which is hard to measure, capacity which means

the experience of the business owner and then the cash flow or the financial strength of the business and I'll go over them real quickly but the credit's very easy [as] we can pull [off a] credit [report] to determine…whether they have a history of paying,…we look at both the business cash flow and the personal cash flow, are there other revenues in household, outside the business and what are the revenues of the business so we do what I call a business cash flow and a personal cash flow,…we just look at the value of the collateral and the value weight of that collateral, the character of the person is a little more difficult to measure [because]…that's more qualitative and that's through the interviews and interaction with the loan officer and finally, the capacity of the owner which is really the experience, if they're starting a restaurant they really need to have experience in that, we don't want someone that was a construction worker [and] all of a sudden wants to open up a restaurant, that wouldn't rate very well on capacity or experience. So we really measure and document the experience of the business owner' (3a, US, 13.10.05).

CDFIs use more time consuming and more expensive, qualitative assessments which are used to supplement quantitative evaluations when information asymmetries occur (Cressy, 2002). As such, CDFIs develop a close banking relationship with their clients based on trust (BOE, 2000; NEF and Nicholson, 2003):

'there are occasional people who will come to us, somehow they've heard about us or they've used us in the past and even though now maybe they

> can go to a bank sometimes they'll stay just because of the loyalty thing or they just feel more comfortable, they know you, you speak their language…But in general…we're really a starting place for somebody who doesn't have more traditional sources of credit' (4a, US, 17.10.05).

Cressy (2002:F7) suggests that relationship lending occurs in the case of less established enterprises whose track record is 'informationally opaque and where the association is closer and more personal' that cannot produce evidence of their business activity. It is even more pertinent that CDFIs establish close relationships with those with a lack of track record or information asymmetries during the due diligence process for them to access finance from a CDFI. This suggests that the loan process remains challenging, with research showing that SMEs face significant barriers to accessing finance without sufficient information, track record or sufficient collateral (Berger and Udell, 1998; Cressy, 2002; De Meza, 2002; Stiglitz and Weiss, 1981). Interestingly, it is believed that CDFI applicants consider that they are assessed on:

> 'their skills, their experience, their background, [and if] is there actually a market out there for what they're trying to do' (9a, UK, 10.02.06).

Applicants do not consider their ability to repay the loan as part of their assessment. The decision making process for loans is dependent upon the amount required. This process varies according to each CDFI. But in general, if the loan is for less than $5000 or £5000 then it can be authorized or declined by one loan officer and signed off by the Chief Executive or Manager. If a loan is for a larger amount then a number of loan officers and the credit/or lending committee will decide whether it fulfils the required social and economic criteria before a decision is made.

CDFIs are social financial institutions and their lending process is assessed on both social and economic criteria and this can make the lending decision problematic (Bryson and Buttle, 2005; NFSNR, 1999). The key social criteria for enterprises to be authorized a loan is for them to provide employment for local people:

> 'Well the two principal ones are that the organization that approaches [the CDFI] be it a social enterprise or a for-profit business, [they] have got to have been declined by the bank wholly or partly for the finance they are seeking, they have obviously got to be based in [our operating] areas and most importantly for [the CDFI] to get involved in a project there's got to be some benefit to the local community and that can be either by way of job creation or job preservation…or the organization performing a service which is demonstrably of benefit to the community…For example it's people providing foster care or people who are providing care for elderly people in their home, that type of thing where there's a defined social benefit…the other criteria are that the loan obviously…has got to be between £2,000 and £50,000, we will look at propositions where they will be located… and if they are employing let's say half a dozen or so employees that all lived in the [operating]...area then so long as everything else stacked up then we would actually look at it, obviously the borrower has got to complete an application form, supply a properly constructed business plan and then one or two other things like bank statements and personal asset statement, credit reference search that type of thing, that's essentially it really' (8b, UK, 10.01.06).

This supports Bryson and Buttle's (2005:279) argument that the CDFI lending process represents an 'alternative discursive' process. In this way, CDFIs are reducing financial exclusion by authorizing loans to viable businesses that are rejected by the mainstream. Nevertheless, the lending decisions rely on old relationship banking practices and the use of lending committees to determine the risk/reward ratio on an application by application basis. In this way, 'too low a risk will exclude too many firms from the…[CDFIs] funds while too high a risk will threaten the…[CDFIs] long term future' (Bryson and Buttle, 2005:279).

Conditions of the Loan

The risk of making loans and the issue of default are reflected in the interest rate charged, the level of security taken, and the markets served by the US and UK CDFI case studies. Interest rates vary vastly between CDFIs and the markets that they serve. The interest rates range from 1% to 24% (Table 5.1, Table 5.2). The rates charged by CDFIs are so varied because CDFIs are unregulated and it depends upon where they access their funds. For example, CDFIs that were able to obtain a grant for their lending activity and operations perhaps lend at a lower rate than those CDFIs that have had to use loans obtained from mainstream banks to support their operations. Moreover, it depends on the knowledge, experience and strategy of the CDFI team and board of directors and the CDFIs strategy. If a CDFI is forward thinking and aims to be sustainable in the long term by not relying on public funding, then the interest rate charged reflects this, although there are questions around those CDFIs that lend at a significantly higher rate than banks. The majority of loans for social enterprises have lower interest rates than for-profit businesses due to lower levels of risk, lower default rates and availability of security which was the case for the majority of US and UK CDFIs. Start-up businesses are also likely to experience high rates of interest although again this depends on the CDFI and if they lend to the start-up market. Lending to clients that are on the commercial margins is challenging as CDFIs should not compete with mainstream banks. The US CDFI case studies small business lending teams mitigate risk by providing other services to clients such as technical assistance and always take collateral in the form of personal guarantee, security and/or SBA Guarantee. In addition, US case study two would even like to devise a credit scoring model for CDFIs. Due to the risk aversion of case study two, they have been able to become 91% sustainable (Appendix 5.1, 5.2). It is important to note that US CDFIs are not lenders of last resort and request collateral against their loans, making them risk averse and in many respects they act like mini-banks.

It is interesting to note that overall there are few declines in the small business market in any of the US CDFIs examined. This could be a result of the fact that they are not lenders of last resort and that they take between 50 to 100% collateral for each loan. At one US CDFI, if an applicant does not have collateral the US CDFI can guarantee the loan from the Government's SBA programme. It was found that US CDFIs are not necessarily embedded in local and national networks as there is a culture of competition between US CDFIs and for funding. This reflects the low number of applications that are declined, especially in housing and community facility applications and highlights the significance of CDFIs in such markets where the welfare state does not exist. US CDFIs have continued public sector support for their operations and are able to guarantee their lending and take on additional risk compared to UK CDFIs that have lost the support of the Phoenix Fund. According to two US CDFIs, the increased use of credit scoring by banks has made it more competitive for US CDFIs to find suitable deals as some banks have entered the small firms loans market.

The loan application consists of three processes; referrals, application assessment, and the conditions of the loan. At the first stage of the application process, CDFIs rely on a constant flow of potential deals, and referrals from a variety of sources are required. However, UK CDFIs are currently experiencing a lack of deal flow. The twist to the referral process and the key to UK CDFI activity, is that the firms applying for a loan have been rejected by mainstream financial institutions or in the case of US CDFIs, firms would be unlikely to be able to access finance from banks. In this way, during the second stage application process, CDFIs need to assess an application with due diligence so as not to experience adverse selection or moral hazard caused by information asymmetries, and or with a lack of track record. CDFIs mitigate these risks by utilizing ‘alternative discursive’ lending practices (Bryson and Buttle, 2005). The final stage of the application process, if the loan is approved, is to determine the interest rate of the loan and, if applicable, the level of security that the CDFI can obtain to support the loan and to reduce the associated risk. The loan conditions reflect the level of risk identified by the CDFIs lending team. Throughout the loan application process, the CDFI applies its social and economic objectives in order to fulfil its purpose of providing access to finance to the financially excluded, even if the CDFI objectives are not balanced. The US and UK CDFI application process demonstrates the inherent tensions and risks involved in lending to underserved markets, whilst also balancing issues of organizational sustainability.

Post-Loan Process

The CDFI post-loan process involves monitoring loans, what actions to take if and when loans default, the provision of business support services, and performance measurement (Figure 5.2). Monitoring the CDFI clients has three purposes. First, it identifies any problems that may arise with either loan repayment or business support. Second, it is used to evaluate the quality of the CDFI application process. Third, it is used to target additional business support and/or financial advice. In both US and UK CDFIs, the monitoring process is undertaken by the loan officers and in some cases with the assistance of back office support systems. In a minority of cases the monitoring process is segmented with a separate collections and/or service department supporting the lending team. This is to make the monitoring process more efficient. The process for following up clients that have defaulted is through the lending team, a 'client liaison officer', collection or service department which in some cases consists of one person. Any US borrowers that do default tend to have their loan restructured, thus hiding the true financial viability of the businesses that are supported by US CDFIs:

> 'the loan consultants need to be able to focus on making sure that the new loans and the refinancing [of] loans are the top priority, so they're always there for the clients but many of the requests are administrative requests [that] are then handed off to [the] service centre but also the loan

consultants keep in contact with all the borrowers on a regular basis' (4b, US, 17.10.05).

The restructuring of loans and separation of the loan process is more common in the US than the UK. As they have taken security from the client to guarantee the repayment of the loan, US CDFIs are more stringent about debt collection when a loan defaults.

One UK case study asks clients to assess the loan application process after 3 months in order to grade assistance, advice and the impact that the loan and support has had on their business. This CDFI has achieved a response rate of 45% for the questionnaire and tries to resolve any support issues that are raised by the clients. However, the survey undertaken by this UK CDFI was more in the interest of the CDFI improving and measuring the effectiveness of its operations. Similarly, case study 11 sends out a yearly questionnaire to their active clients (those clients that are repaying their loan). However, their latest questionnaire had a response rate of just 17% which suggests that the CDFIs relationship with their clients is distant. Three of the UK CDFIs examined had undertaken post loan surveys whereas in the US due to the proliferation of business support administered alongside the loan, only one of the US CDFIs had completed an in-depth qualitative impact study of their clients.

Figure 5.2: The US and UK CDFI Loan Monitoring Process

Month 1 Payment due

Non-payment

Telephone Reminder

Default

Letter reminder

Default

Visit Client at site of business

Reschedule Loan (If Contact is made between Client/CDFI)

Default

Write off Loan

Month 6

(Source: Own research)

Business Support

In the US, CDFIs view business support as integral to their missions in helping small businesses to become investment ready, grow and succeed. As such, all US CDFIs explored offered either one or a number of the following facilities to their clients: financial literacy courses, capacity building, technical assistance such as referrals to accountants and marketing. Business support is offered alongside loans as part of the US

CDFIs mission to support enterprise. However, Storey and Wren (2002) question the effectiveness of business support given the business survival rate. Business support is part of the financial literacy programme under the CRA. It is believed that by educating business owners about operating a business and developing skills they perhaps lacked, a CDFI is doing as much as possible to ensure that the loan is repaid and monitor their client. Often these support services were free to clients and subsidized by external funding sources whether undertaken in-house or referred to external sources:

> ‘we got some grant funding to provide technical assistance to a number of our business clients. We figured out that if a number of these people were new or emerging companies then they probably had issues of various sorts whether accounting, marketing, legal,…you name it they would probably have issues that we would try and help out with to ensure that their business is more of a success’ (2b, US, 11.10.05).

Yet increasingly, according to one source, these services offered by US CDFIs that were not originally loan funds, were being paid for by clients as they are expensive to deliver and the high cost per loan was deemed unviable in the long term. Technical assistance as business support is known in the US is a contentious issue at present:

> ‘all of our entities are struggling with it and their struggling with it in different ways. I think in general they’ve all come to the conclusion that it would be really good if we offered technical assistance, if the technical assistance we offered was so valued by the borrowers that they were willing to pay something for it. They might not have to pay full rate but that they should pay something for it…[one CDFI] came to the conclusion

> that while there was certain kinds of technical assistance they could offer...it wasn't worth it and so they do very little sort of general entrepreneurial education anymore…but they have partners who they work with…so what they've done is try to build a network rather than do it themselves' (7a, US, 07.03.06).

As such, support services are contracted out by the majority of US CDFIs alongside the loan but not necessarily as a condition of the loan. It is worth noting that two of the US CDFIs were primarily enterprise organizations and have since added loan funds to their operations. This suggests that these CDFIs are policy led.

In the UK, business support takes a different role within CDFIs. All but one UK CDFI delivers financial advice or refers their clients to business support agencies or officers such as accountants, solicitors and so on depending on their client's needs. The one exception has business support in-house which for consultancy clients pays one-third of the cost whilst one- to-one training is free to the client. The key issue for UK CDFIs with regards to business support is:

> 'That [it] depends on the borrower really, it could do with being better…but I think its more [of] a general comment. It shouldn't necessarily be down to just us to provide it …I think it should be generally available from people like Business Link and the Chamber [of Commerce]…and I think perhaps in certain cases the businesses …where the quality of the people running them aren't as good, then that's where post-loan support would be of particular benefit. The well-run businesses,

> they need little in the way of post-loan support because they know what they are doing, they know where to get business from. It's the…poorer quality businesses and I mean we've found in our own pilot that…unless you actually do it from the word go, from when you've lent the money, trying to come back to it 12 months after you've lent the money is almost an impossible task but despite the fact that you're offering them a free service they become set in their ways and don't want to listen to other people advising them on how they should proceed' (8b, UK, 10.01.06).

Business support is viewed as something that should be sought by the business owner, preferably prior to accessing a loan and tailored for their individual business needs. In relation to its high cost and the quality of the advice, the business support services delivered by the public sector are deemed to be poor and to lack relevance for micro and small firms (NEF and Nicholson, 2003). Thus 'there is a real reluctance of borrowers to actually engage in those services' (8g) which is both disappointing for UK CDFIs trying to aid developing businesses and for those businesses struggling alone when support is available from Business Link or enterprise agencies. NEF and Nicholson (2003:25) suggest that UK CDFIs give informal business support although this is:

> 'costly and it is extremely difficult for CDFIs too earn sufficient income off their lending operations to cover these costs'.

The overriding issue throughout the referral, application and monitoring process is trust, in that the loan can be and will be repaid (BOE, 2000; Granovetter, 1985; Uzzi, 1999; Uzzi and Gillespie, 2002; Uzzi and Lancaster, 2003). Trust is especially important between the client and lending team as they are the link between the business and the CDFI.

Performance Measurement

This part of the chapter explores the significance of measuring CDFI performance, the outputs and impacts that are evaluated and the issues that the sector faces. Best practice is characterized, in part, by benchmarking (Schoenberger, 1997). Even so, measuring the performance of US and UK CDFIs is challenging for the whole of the CDFI sector, yet it is essential for accountability so that CDFIs can benchmark their activities against other CDFIs in their markets and for attracting public sector funding and private investment into the sector (Collin *et al*. 2001; Benjamin *et al*. 2004; NCCA, 2005). In this way, both social and economic criteria are measured in line with the mission statement of CDFIs. By having to fulfil the double bottom line illustrates why reaching sustainability is so important for many CDFIs yet is extremely challenging (NEF and Nicholson, 2003). Sustainability is essential if there is loss or further reduction of public sector support for CDFIs. If CDFIs do not develop partnerships with the CDFI sector, its supporters, and the local community, negative perceptions of the CDFI industry could result. Currently, this is countered through the increasing professionalisation of the industry as currently CDFIs are perceived by the private sector as an ‘amateur market’ (2e, US, 11.10.05), being relatively new financial institutions.

The key CDFI performance measures are through the number of jobs created and/or retained, number of loans authorized and also the number of women-owned and ethnic minority-owned businesses that are financed by CDFIs. US CDFIs also measure: number of housing units created, number of loans, total $ loaned, rationale for loans, impact (qualitative) and outcomes (quantitative), income, home address of business owner and address of business, and immigrant status. Measurement is dependent on the sector and the stage of development that a CDFI has reached. The OFN has developed the CARS programme to measure financial performance and social impact to standardize reporting and attract investors to CDFIs (NCCA, 2005). Mature US CDFIs have a major advantage in accessing funding as they have recorded their outcomes which reflect the diversity of their activities and are working towards assessing their impacts which they are confident will result in improvement to their ability to attract sustainable funding from both private investors and public sector sources. Many UK CDFIs have yet to grasp the importance of measuring the outcomes and the impact of their activity.

The US CDFIs surveyed had authorized between 214-7000 loans to small businesses since their inception. The largest small business portfolio was $75 million which reflects the high demand for finance or the fact that they are not lenders of last resort. The bad debt rate varied between less than 1% to 15%. This US case study explains its attitude towards loan performance and risk in the following way:

> ‘The loan performance is basically … how much money we lost and when we created this loan fund we set aside 30%, we said 30% we’re gonna lose for sure. Right now the loss ratio is 9%, so we’re very happy with that. Now it’s expected to increase a little bit in the next year or two, this year maybe up to 11 or 12%…because it’s inevitable I mean its as the loans get

> older,…the borrowers aren't gonna pay you back and I wouldn't be surprised if this year if we had a few more businesses withholding and we have a few loans where the borrowers are really good and call in saying 'listen right now I can't pay you so can we restructure the loan?'' (1a, US, 07.10.05).

In some cases, the enterprise loan default figures have been merged with other markets (housing, community facilities) or the loans have been restructured. The default rates are not true indicators of small business delinquency rates. The figures produced by the CDFI sector are unclear as the US CDFI annual reports merge default rates experienced in different markets. The US evidence indicates that there is a gap in the market for finance for enterprise. But it is difficult to determine to what extent the gap has been filled as US CDFIs are not lenders of last resort. Nevertheless, as Marshall (1930) stated in 1930, it is important to consider that the markets are in a constant state of flux which makes the finance gaps time and space specific. The UK CDFIs examined approved a mean average of 700 loans since their inception creating and/or preserving between 220 and 2310 jobs in the process. The number of loans and jobs vary not due to the length of time that the CDFI has operated but due to the size of loans that they offer and the markets that they operate in. The bad debt rate varies between 8% and 22%, indicating that when compared to the average of the US CDFIs of 12.4% the UK is similar to the US CDFI case studies with an average default rate of 13.08%. Yet, the average default rate of the UK CDFI case studies is low in comparison to the US rate which is reported to be 18% due to the predominant micro finance sector (CDFA, 2005:43). When the following UK CDFI was asked how they measured their CDFIs performance, they replied:

> 'The flippant answer is that I measure it by the big smile on the client's face when they actually go out with a loan when they haven't been able to get one and I would measure it secondly, by wonderful successes you have when you see someone who has made a success of the money you've given them, lent to them rather than somewhere else... Over the years the real true answer has been from the point of view of the public sector, it ends up being outputs and as a mission I've always been very, very strong on local jobs for local people. The real answer to the question has to be in a statistic of how many jobs the businesses have created or preserved however, I am very conscious like many of the vagaries of that analysis that probably there's a real big issue coming up with the money away from the Phoenix to local money from [the RDA] as to just how much monitoring you can do. They are starting to talk, for example about…getting measurements from clients about which postcodes the employees are in and doing it on a regular quarterly basis. Well for me that's putting up a big barrier with the clients as to whether they'll take the loan in the first place. After all, you are lending to them at a commercial rate. So I think the true measures are the measures each year on your balance sheet, they show you're growing, the fact that quite proudly you can point at the balance sheet now and say well there you are, we've got net reserves of about £1.5 million so we are a being to be reckoned with

> and that you keep the level of bad debts that you are suffering down to below the level you have got cover from the public sector' (8a, UK, 13.01.06).

Perhaps the real indicator of CDFI activity is the number of jobs protected through lending to enterprises located in disadvantaged areas. In this way, there is still a certain level of risk involved and the CDFI is attaining its depth of reach.

The increasing significance for public and private subsidized programmes to demonstrate their validity demonstrates the need for CDFIs to show accountability, for example, at UK case study 9, it is one person's sole responsibility to look after all evaluations. Publicly funded projects (CDFI Fund, DTI, SBS, *Office of the Deputy Prime Minister* (ODPM)) require quarterly internal and annual external evaluations. Therefore, funders require accurate and up-to-date information which can impact upon the efficiency of the CDFI as the evaluations are time consuming and therefore costly. Despite the measuring of key outcomes and impacts, there remains an 'endless tension' (2e, US, 11.10.05) between achieving social and economic objectives particularly in the small business financing market:

> 'I think there is tension in…whether they are true statistics, there's no tension in measuring performance in the number of loans delivered and value of loans delivered, there will always be a question mark about the quality of the jobs, whether they are sustainable, how long are people going to be in jobs but that's the only thing we do...The one big problem within the CDFI sector is you will not be able to compare [one

CDFI]…doing 60 loans value £1 million with [another]…doing 60 loans value £100,000 - how do you compare that?...you can't' (8a, UK, 13.01.06).

In other words, further work is needed on defining performance measurement in the UK (Collin *et al*. 2001; NEF and Nicholson, 3003). From the evidence highlighted here, the key question is: how do you compare or benchmark CDFIs against each other? The simple answer is that it appears to be that they are complex, diverse financial organizations that are difficult to define and measure (Figure 5.5).

Figure 5.3: Similarities and Differences between US and UK CDFI Operations

	US CDFIs	UK CDFIs
Pre-Loan Differences	• Markets served- primarily real estate loans which balances risk of lending to underserved communities	• Markets served- primarily business and personal loans
Pre-Loan Similarities	• Missions	• Missions
Loan Application Differences	• Not lender of last resort • Take security	• Lender of last resort • Only take security if available
Loan Application Similarities	• Application assessment	• Application assessment
Post-Loan Differences	• Provide business support • Restructure loans if default	• Largely refer to external business support or provide business support
Post-Loan Similarities	• Benchmarking undertaken • Monitor loans	• Monitor loans

(Source: Own research)

The post-loan stage is complex and the tension between the social and economic objectives within CDFI activity is perhaps most evident when loans default. On this basis, the loan monitoring process (as well as the application process as a whole) requires trust. Trust and communication between the CDFI lending team and the firm is important. Without trust, the wrong loan decision is made, the loan is at risk of not being repaid and the CDFI is seen as an easy way of accessing money. Communication between the firm and CDFI ensures that some issues of repayment may be resolved, for example the loan can be restructured or the firm can have a short repayment holiday, although this is more common in the US than the UK.

Managing a CDFI is an enormous challenge. CDFIs are managed in an attempt to balance the double bottom line but also to take risks but without overexposure to high default rates. This type of business requires a constant state of balance, yet this balance changes on a daily basis. CDFIs that have a high default rates indicate that the CDFI has put itself in jeopardy, whilst conversely, CDFIs that have low default rates suggests that they have not taken enough risks. These examples demonstrate the significance of business support in order to get firms to operate effectively. However, business support is available from all of the US CDFI case studies, compared to just two of the UK CDFIs. Compared to UK CDFIs, the US CDFI sector has developed benchmarks and made CDFIs accountable for their lending activity. Yet, uneven performance measurement in the US by the OFN reflects the challenges in recording CDFI activity, and raises the question of how and why should CDFI activity be measured? Arguably, the main beneficiaries of performance measurement are the investors, rather than the CDFIs themselves.

Conclusions

This chapter has explored the issues surrounding the nature of US and UK CDFI operations. It is clear that both the UK and US CDFI sectors share the same fundamental aims. Yet the institutional context, lending focus, and scale of the CDFIs differ markedly. US and UK CDFIs experience a number of tensions due to the nature of their missions. US CDFIs face a number of challenges in their operations as they are competing with banks due to CDFIs not being lenders of last resort. As a result, it could be interpreted that US CDFIs are operating as mini-banks as they rarely take risks without collateral and are increasingly formalizing their operations as they are standardizing performance by creating benchmarks for the CDFI industry. Conversely, UK CDFIs are lenders of last resort (NEF and Nicholson, 2003) which means that all applications undergo a process of due diligence to ensure that they meet the demands of a double bottom line. US CDFIs subsidize business lending through housing and community lending which rarely default as they are secured against ‘real estate’. In both US and UK CDFIs, it is thought that business support services can subsidize loan operations. Through balancing risk between the markets they serve, increasing professionalisation of the sector and providing business support services alongside a loan, CDFIs are becoming increasingly influenced by orthodox practices. Moreover, US CDFIs operate in ‘emerging markets’ (2h, US, 11.10.05) at the frontiers of disadvantaged areas. Similarly UK CDFIs are targeting their operations in ‘transitional areas’ of deprivation (9c, UK, 10.02.06) which could indicate that US and UK CDFIs are either ignoring truly disadvantaged areas to reduce risk or those in deprived areas do not want or seek loan finance. US and UK CDFIs could be deemed hybrid financial organizations that are shifting the boundaries of alternative and orthodox financial systems and practices to meet the requirements of their missions. However, the notion of hybridity suggests that CDFIs are undergoing processes of constant change as they respond to alterations in the markets they serve and in the institutional and policy environments in which they operate. In reality, alternative financial practices are being distorted or undermined by the increasingly mainstream financial practices that CDFIs are adopting in order to maintain their own viability and sustainability.

CHAPTER 6 BALANCING US AND UK CDFI OPERATIONS: FINANCIAL VERSUS SOCIAL OBJECTIVES

This chapter explores the embeddedness and the network relationships that surround US and UK CDFIs as they try to balance their social and financial objectives. CDFIs must be embedded in the community through networks with public bodies, banks, business associates and clients. CDFI networks act as third party referral mechanisms. CDFI embeddedness is constrained by the flows into the organization or the sources of finance. Flows out of the CDFI or the uses of finance are determined by local CDFI contact networks which include the contacts of staff members, board of directors, lending network, existing and former clients and business support services. This chapter highlights how and why it is important for CDFIs to become embedded within the local economy and also to embed themselves in the CDFI sector and funding streams at different times and places.

The purpose of this chapter is to explore the issues concerning US and UK CDFIs at the time the research was undertaken. The notion of time in CDFI activity is important owing to time constraints on the sources of funds, as funding streams change and as the demands of the market constantly change. It is, therefore, important to remember that the issues explored within this chapter are time and place specific. The first part of this chapter explores the flow of funds into US and UK CDFIs. The second part of the chapter explores the operating environment of CDFIs. The third part of the chapter explores flows out of CDFIs as the funds are lent to the financially excluded. The final part of the chapter explores if and how CDFIs can balance their social and financial objectives through their operations which leads to the issue of how US and UK CDFIs measure their performance. It demonstrates the fundamental tension that exists in balancing CDFI social objectives against financial objectives. This chapter highlights the complexity of CDFIs, which are largely not-for-profit social enterprises that must try to balance a range of social concerns with a set of financial objectives.

Embeddedness

CDFIs need to be embedded in networks of relations to secure funding to support their lending. US and UK CDFIs may embed themselves in different networks at different times to secure funding, to maintain their operations and serve their market. As US and UK CDFIs operate within the underserved communities of deprived areas, it is important that they embed themselves within that local environment and also network with other national (and perhaps international) organizations. This is so that they have a mix of strong and weak ties to access information and work collectively to achieve a particular mission. It is important to clarify that embeddedness is not limited by geography and can have multiple geographies (Ettlinger, 2003). CDFIs need to embed themselves in three types of networks: first, funding networks; second, the underserved markets that they focus on; third, the business support networks to access clients and to receive advice. In sum, US and UK CDFIs are situated within diverse and complex networks. CDFIs are designed to be effective in certain communities and efficient in delivering their services. On this basis, it could be suggested that US and UK CDFIs are creating new patterns of finance through deprived communities in which they operate and embed themselves.

US and UK CDFI networks comprise; investors/supporters, other CDFIs, trade associations, Government (local, regional, national), board of directors, staff, intermediaries (including banks, accountants, brokers) and clients. These contacts relate to CDFIs in a variety of ways depending on how funding is sourced and utilized. Communication between contacts within networks is through formal and informal exchanges in a number of different ways and places, although this is dependent upon how the relationship was initially established. For example, work contacts can be made through attendance at finance events, and friendship networks can be established outside the work environment. However, these relationships only exist as long as they are positive and/or relevant. For example, an intermediary that refers clients to a CDFI that are continually declined loans will be less likely to refer clients to the CDFI in the future. US and UK CDFI board members have a unique role to play in reaching out to the community. Through their own networks and skills, they are able to link potential funding opportunities and clients with their CDFI. The CDFIs can use the knowledge and experience of their boards to keep their operations focused and also to develop a wider perspective. It is interesting to note that not one interviewee mentioned the word ‘community’ in terms of its market. Instead, the term ‘client’ is used. Some CDFIs appear to focus on the economic rather than the social or community success of the CDFI and this perhaps explains the balance between efficiency and effectiveness. Depth of reach is defined as those CDFIs that are actively accessing those who are financially and/or socially excluded (Nicholson, 2004). Some CDFIs achieve their depth of reach through investing in SMEs that are located in disadvantaged areas or employ excluded groups (Nicholson, 2004). As such, a CDFIs target market is largely dependent upon its contact networks. In addition, CDFI networks are active and change according to the sources and uses of finance.

Flows In: Sources of Finance

US and UK CDFIs obtain funding from a variety of sources. CDFI funding is primarily obtained from central and/or regional Governments, not-for-profit foundations, religious institutions, private/corporate (banks), civic (individual) investors and from their own revolving loan fund. Tables 6.1 and 6.2 highlight the range of funds that CDFIs receive. These tables (6.1, 6.2) show the variety of funding from both private and public sources. By receiving a range of funding, CDFIs ensure they do not rely on one funding stream. If one source of funding is withdrawn then a CDFI can still function as it has a number of other sources to rely upon. Many CDFIs, however, are dependent upon one or a few key sources of funding. Some CDFIs operations and markets are largely dictated by Government policy and funding. With the loss of the UK Phoenix Fund, for example, many CDFIs are undergoing a transitional shift from enterprise lending towards personal lending as other public funds are available. Consequently, some CDFIs are adapting their strategies towards the supply of funding rather than the demands of the market. By having a diversified funding portfolio, CDFIs can remain flexible in terms of their markets and strategies. A diverse range of funding means that a CDFI must be embedded in different ways in order to access diverse funding streams. To access public funds CDFIs need to be embedded within local, regional, or national political networks; key actors involved with UK CDFIs such as board members and Chief Executives need to have established links with the Local Authority and other local and regional agencies. In addition, a variety of funding sources allows CDFIs to realise their mission of balancing social and financial objectives through their loan markets and ensuring that they remain independent, autonomous organizations. Those CDFIs that rely on a few key funding sources have either followed the funding that has been available or have become more commercial in their operations and are able to leverage funding from the mainstream banks.

Table 6.1: Sources of Finance Used by the US CDFI Case Studies

US CDFI	Case Study 1	Case Study 2	Case Study 3	Case Study 4	Case Study 5	Case Study 6
CDFI Fund	X	X	X	X	X	X
State Government	X	X			X	
City Initiatives					X	
Foundations	X	X	X	X	X	
Religious Institutions	X	X	X		X	
Corporate Investors	X	X	X	X	X	X
Civic Investors	X	X	X		X	X
Deposits						X

Key
Funding sources are not in rank order
Abbreviations:
CDFI Fund- US Federal Government Funding Support for CDFIs

(Source: Own research)

Table 6.2: Sources of Finance Used by the UK CDFI Case Studies

UK CDFI	Case Study 7	Case Study 8	Case Study 9	Case Study 10	Case Study 11
European Funding		X			
DTI			X		
ODPM			X		
Phoenix Fund	X	X	X	X	X
RDA	X			X	X
Local Authority		X			X
Foundations	X			X	X
Banks	X	X	X	X	X
CITR	X		X		
Private Investors	X	X	X		
Shareholders	X				X
Regeneration Funding					X
Lottery					X

Key
Funding sources are not in rank order
Abbreviations:
Phoenix Fund- UK Government Funding Support for CDFIs
CITR- Community Investment Tax Relief
DTI- Department of Trade and Industry, UK
ODPM- Office of the Deputy Prime Minister, UK
RDA- Regional Development Agency, UK

(Source: Own research)

Tables 6.1 and 6.2 show the different funding networks that CDFIs are embedded within. The most common source of funds accessed by US and UK CDFIs were from Government (US CDFI Fund and UK Phoenix Fund). This is despite the reduction in the US CDFI Fund and the demise and loss of the UK Phoenix Fund. The issue in the UK is one of timing as the Phoenix Fund has recently closed and there has been a lack of financial vision in the transition period between closure and the establishment of another public source of finance. As such, US and UK CDFIs could have diversified their funding source portfolio to account for the decline in funding, and this may have led to a change in their operations, markets and strategies. In the US, all CDFIs have obtained funding from corporate investors (banks), as a result of the CRA which forces financial institutions to lend to underserved markets. Many banks support CDFIs rather than directly lending to deprived communities themselves. In the UK, banks largely support CDFI activity through CSR and/or through loans to CDFIs that have a track record and that can provide a guarantee for their lending, which usually comes from public funding sources. All but one US CDFI received funding from foundations; this support is held in high regard due to the difficulty in accessing such funds. Foundation or not-for-profit funding is difficult to attain in the US and UK due to the requirements laid down by these organizations. These include a track record, fulfilling financial and social objectives and being an example of best practice. According to a number of US CDFIs, the US has a strong philanthropic investment culture hence the majority of US case studies receive funding from religious institutions and civic (individual) investors. One US CDFI noted that:

> ‘until recently the bulk of [our funding]… was really coming from philanthropy’ (4a, US, 17.10.05).

The lack of State wide and city initiative support for CDFIs reflects the different and uneven nature of State and local Governance in the US. In the UK, there is a wide variety of funding sources which reflects the fragmented nature of public and private funding schemes. The diversity of funding available in the UK for CDFIs suggests that the CDFIs are working in different markets and working towards different objectives. The CDFIs that have obtained public funding from Europe, Government departments (DTI, ODPM) and Local Authorities indicate that they are fulfilling social objectives such as tackling unemployment and social welfare issues. In the UK, the lack of support from CITR suggests that the requirements to become part of the scheme are demanding and that there are barriers to accessing the source of finance, for example the absence of a track record. The UK CDFI sector is dependent on public institutions for funding support which could be a result of UK CDFIs being lenders of last resort and their clients not having access to collateral. It may also be due to the comparative youth of many of the institutions. Consequently, UK CDFIs perhaps take on additional risk to their US counterparts that are not lenders of last resort and are able to access collateral to guarantee the loan. The sources of CDFI finance are constrained by the policy environment, organizational requirements of funding schemes and limitations on how the finance can be used.

CDFI funding is sourced through networks involving conferences, presentations, seminars, and strategic marketing to those who have worked in Government funding schemes, financial institutions and community networks. In smaller US and UK CDFIs, one person is usually responsible for obtaining funds. In larger CDFIs, especially in the US CDFI case studies, the manager of each loan department or marketing department is responsible for securing funding. Funding networks are determined by contacts generated whilst at previous employers, which are generally financial institutions or Government organizations (i.e. public funding schemes, Local Authorities). The variety of US CDFI funds has created networks that are fragmented and dynamic, although the CDFI funding processes are not without tension, as explained by one US CDFI:

> 'Here we are private, in the public interest, managers of capital and it's incredible for our credibility not to be influenced, we'd rather not take the money [because] we, most of our capital is from individuals and institutions…and we have lots of relationships that accrue from those relationships to capital so there are people who come to bat for us if we're getting undue pressure and we don't have to put up, we don't need to put up with it. So it gives us some flexibility to move and to leverage dollars and…perform. The cost of that is we have to be transparent, we have to do what we say we do…we have to be able to document it and we have to give up something that's not working and keep thinking about how we might do something differently' (2d, US, 11.10.05).

This highlights the tensions in accessing sources of funding, the expectations of potential and actual investors, and this raises issues of conflict between accessing funds and the uses of funds. US and UK CDFIs are independent social enterprises and should act solely in the interests of their organization, mission and clients. However, investors have demands of their own, especially in terms of how the funds can be utilized, for example at one US CDFI an investor stated that their investment could only be used for providing loans to community projects even after it had been repaid. Investors can, therefore, place restrictions on funds that are in their interests rather than for the benefit of the markets served by the CDFI. The US CDFI quoted above has a history of successful operation. Owing to this CDFIs' strategy and longevity, it also has diverse funding streams and operates in a number of separate markets. Unlike many other US and UK CDFIs, this allows it to work in a variety of markets without pressure to shift markets according to current trends in the sourcing of funds or to conform to investors' wishes. For example, investors may only want to fund community projects. In order to maintain its flexibility, however, the CDFI has to demonstrate successful performance to investors. It can also alter the market it lends to as well as the sources of loan finance.

US case study 2 has an investor profile that includes individuals, religious institutions, banks, foundations and Government (Table 6.1). 80% of this case study's investors (largely individuals, religious institutions and foundations) provide a marginal amount of the fund's capital (20% of total capital). The remaining 20% of investors are primarily financial institutions and Government. This breakdown of US CDFIs indicates that the most important source of funds came from corporate and Government sources rather than individuals and social investors (Table 6.3). In the US, there are issues with investor development as a CDFI investment is neither a charitable contribution nor a market-rate investment. Potential investors could be unfamiliar with the concept of a CDFI and how their money would be used. Funding is largely in the form of a grant but some investors only want their funding to be used for a specific sector or market which impacts on how CDFIs manage and record their loan portfolio. Despite the time and expense involved it is important that CDFIs communicate regularly with private and charitable investors and provide feedback about their 'investment'. For the US CDFI industry it is an enormous challenge to define CDFI activity and in doing so 'create [a] category' to explain to potential investors what CDFIs do. With unstable Government funding streams, there is enormous pressure on US CDFIs to raise funds from other sources and then retain and maintain that investment, whilst conveying a clear message of what the CDFI sector is and what it does. Clearly, there is a tension in attracting funding into US and UK CDFIs because the public are largely unaware of CDFIs and do not understand their mission. It is difficult to define the social and economic objectives and the diverse activity of CDFIs to investors, especially as the sources of funds and markets for loans shift according to the economic climate. In this way, CDFIs are in a constant state of flux.

Table 6.3: Percentage of Loan and Revenue Funding received by US CDFI Case Study 2 (in US dollars)

US CDFI Case Study 2	% of Funding in $
Accumulated CDFI Fund, Corporate Investors	80%
State Government, Foundations, Civic Investors, Religious Institutions	20%

(Source: Own research)

The level of public subsidy available through the US Federal Government's CDFI Fund has declined in recent years, but this has remained relatively stable in comparison to the

UK's equivalent fund, the Phoenix Fund, which ended in March 2006. All the US and UK CDFI case studies were part funded respectively by the CDFI Fund or the Phoenix Fund (Table 6.4). The US CDFI Fund was responsible for leveraging finance for US CDFIs to on-lend, and acted as a guarantor against lending to underserved communities. Without the support of the CDFI Fund, US CDFIs may not have survived:

> 'we didn't really qualify [for the CDFI Fund] until 1999 and…we had zero equity or company capital or grants in our loan fund, it was all leverage or all debt and you know it was a very risky situation for investors and the majority of our interest went to cover any losses; there was really no money derived for operations from our loan fund. So right about 1999 we got certified by the CDFI Fund and to date we've probably gotten about $3million from the CDFI Fund so far we have about $6 million in revolving loan money and about half of that is equity as a direct result of the Government involvement in providing equity to CDFIs across the US. We've benefited highly from [the CDFI Fund]' (3a, US, 13.10.05).

Without the CDFI Fund many US CDFIs may not have been able to diversify their lending portfolios nor have been able to grow (Table 6.4). Growth is dependent on the ability of a CDFI to generate a surplus to cover revenue costs. Thus, without Government support, the US CDFI sector would not operate as widely, in terms of the markets served or geographical area, as they do at the moment.

Table 6.4: Markets Served by US CDFI Case Studies Prior to the Introduction of the CDFI Fund in 1994 and Post Award of CDFI Funding

US CDFI	Case Study 1	Case Study 2	Case Study 3	Case Study 4	Case Study 5	Case Study 6
Markets Served Pre-CDFI Funding	C, P	E, H, C	H, SME, C, M	M	SME, C	M, SME, C
Markets Served Post-CDFI Funding	M, C, SME, VC, P	E, H, C, VC, SME	H, SME, C, M	M	SME, C	M, SME, VC, C

Key
Loan Sectors:
C- Community
E- Energy
H-Housing
HI- Home Improvement
M- Micro
P- Personal Consumption
S- Small Business
VC- Venture Capital

(Source: Own research)

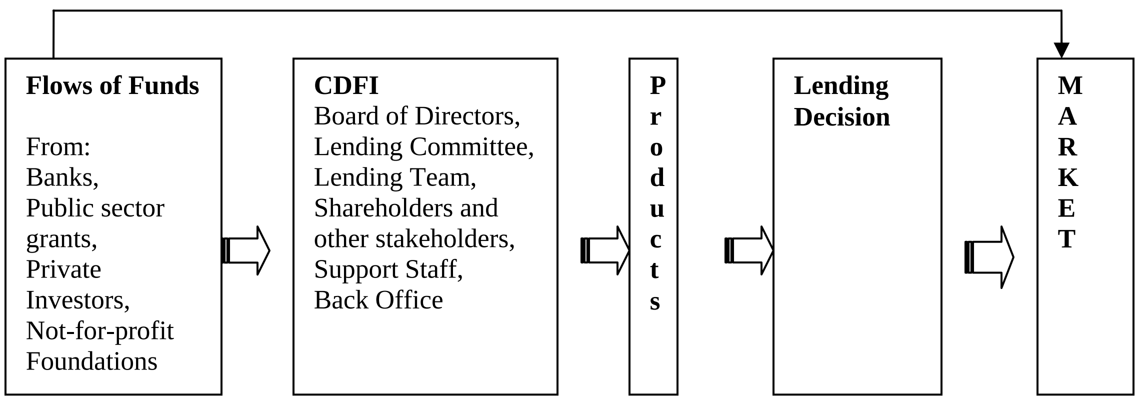
All the US and UK case studies were funded, in part, by banks donating and/or lending to CDFIs (in the US, this was the role of the CRA). For CDFIs to access capital from banks (even if it is at a below market rate), they have to be investment ready and have a proven track record. Investment readiness is when firms seeking finance have viable business plans and an awareness of business practices. CDFIs also face barriers when accessing finance from banks as CDFIs are facing the same challenges as other small firms regardless of whether they are for-profit or not-for-profit. Off the record, the US CDFI case studies believed that bank investment under the CRA was merely a box ticking exercise to fulfil part of their social and corporate responsibility agenda. Nevertheless, the bank loans that are made to US and UK CDFIs and are repaid, are one indication of the financial viability of some CDFIs.

US and UK Operating Environments

This section explores the different operating styles of US and UK CDFIs. It is widely acknowledged that each firm will operate in a different way (Bryson and Buttle, 2005; Storey, 1994). However, it has been possible to categorize CDFIs into a number of styles to reflect the different approaches taken depending on when and why they were established. First, this section explores the US and UK CDFI operating environment and second, the different styles of operating are outlined to show how CDFIs balance their social and financial objectives to highlight how difficult it is for CDFIs to remain true to their missions and become sustainable.

The US and UK CDFI operations are largely determined by the source of funds and clients (Figures 6.1, 6.2). CDFIs also rely on the Government for policy support and Non-Governmental Organizations (NGOs) and banks for referrals and business support. It is questionable whether CDFIs would be able to function without these organizations. Conversely, it is likely that CDFIs would be able to operate without the CDFI trade associations, the US OFN and UK CDFA, although the level of support from other organizations within the operating environment might be reduced. Consequently, CDFIs rely on support from a variety of organizations and are, therefore, part of a much larger system to reduce financial exclusion.

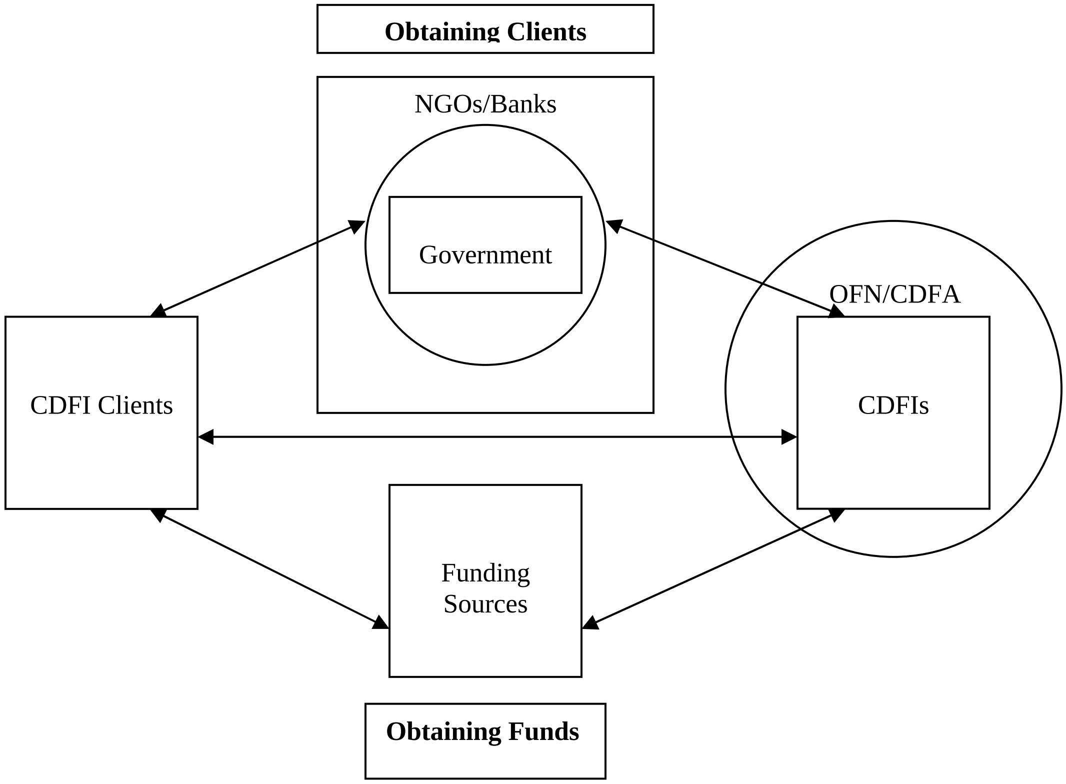
Figure 6.1: Diagram to Show CDFI Operations: Flows In and Out



(Source: Own research)

The way in which US and UK CDFIs have developed their operations depends largely on when they were founded and who they were founded by and this influences the markets, products and strategy of each CDFI. It is important to note that CDFIs can have a blend of influences in their development as they change and grow. The different ways of operating suggest that CDFIs are diverse, complex and continually adapting their operations in order to survive. The next section explores the different types of CDFI according to their strategy and operations.

Figure 6.2: The Operating Environment of US and UK CDFIs



(Source: Own research)

Policy Driven CDFIs and Project Based CDFIs

The UK CDFIs that were founded post 1999 and the US CDFIs that were established post 1994 were established in response to policy initiatives. These CDFIs either created or shifted loan markets to access new sources of public funding. The US and UK CDFIs that were created after the establishment of Government funding support reflects the flexibility of CDFI operations and the transition of the market according to funding streams rather than client needs. There is a subset of policy driven CDFIs which operate a number of funds on a short term basis. As such, they are project based CDFIs. Project based CDFIs tend to be linked to enterprise agencies that deliver grant funded policy directives, for example business support.

Diverse CDFIs

Despite CDFIs being not-for-profit, some CDFIs are becoming increasingly commercial in their operations. These CDFIs reduce their exposure to risk in an attempt to make CDFI activity viable and sustainable. These increasingly commercial CDFIs have diversified their lending to incorporate venture capital and business services. These CDFIs are risk averse due to low default rates and the markets that they serve, operate in emerging markets and have high interest rate levels (Table 5.1, Table 5.2). The increasing diversity of these CDFIs suggests that they aim to be independent of public funding and the lending restrictions that tend to be associated with such funds. In the case of US CDFIs, they are in competition with banks for deals. This suggests that these CDFIs have had to adopt similar approaches to mainstream financial institutions for their operations to remain viable and they may be a short term survival strategy.

Balanced CDFIs

A subset of diverse and policy driven CDFIs have adopted a balanced approach to their operations. Some US and UK CDFIs have remained true to their missions through their operations and lending activities. This is achieved through assessing each loan against their social and financial objectives (their risk reward ratio) to try to create a balanced portfolio. These CDFIs may have a relatively high default level and it could be argued that in this way they are reaching the financially excluded. Also, by having a balanced portfolio, these CDFIs may attract the attention of foundations and not-for-profit investments which are of high value within the CDFI sector as they are hard to obtain. As such, these CDFIs are respected by those within and out of the sector and are models of best practice.

From this, it could be stated that CDFIs have access to certain funds and use those funds differently depending on their strategy, operations and restrictions. The flows of funding in and out of CDFIs reflects the diversity of CDFIs in the US and UK. Moreover, the notion of complexity typifies US and UK CDFI operations which is not dissimilar from Storey's (1994) argument that each enterprise operates in a different way depending on the strategy and characteristics of the business.

Flows Out: Uses of Finance

The first part of the chapter explored how US and UK CDFIs obtained their funding and how the source of funding can determine a CDFI's strategy. The second part of the chapter explores how US and UK CDFIs use their funding, their target markets and how the sources of finance can determine a CDFI's network and therefore, its state of embeddedness within the CDFI sector and its locality. The use of finance incorporates in particular, the pre-loan process of interest rates charged to clients and the post-loan process of default rates incurred by CDFIs (Figure 6.3). This will also highlight the operational differences between CDFIs and banks.

Figure 6.3: Flows In, Flows Out: The Sources and Uses of CDFI Finance

Time →

Flows In: Sources of Finance	**Flows Out: Uses of Finance**
• Public Investment	• Loans to Financially Excluded
• Private Investment (Individual and Corporate)	• Interest rate, Default Rate, Performance Measurement
• Bank Loans	
	• Collaboration between CDFIs and their Networks for Strategic Advantage
	• Social and Financial Objectives
	• Sustainability- Operational/Financial

(Source: Own research)

Figure 6.3 explores the flows into and out of a CDFI and also explores the complexity of CDFI operations and the challenges that CDFIs face on a daily basis. The sources of finance reflect the limited access to finance that CDFIs themselves can experience. Ideally, CDFIs would have a range of sources so that they are not dependent upon one key resource. This implies that CDFIs have to have a broad network in which to tap into for financial and knowledge resources. The different sources of finance can place restrictions on how the funding is spent, and the type of funding can also restrict its use, for example, with a bank loan a CDFI might not be able or want to take as great a risk compared with funding obtained as a grant. However, a grant might only be loaned to a specific target market or geographical area. The funds into a CDFI not only provide the capital for CDFIs to lend but also cover the organization's revenue costs, operations, risk, development and measurement activities.

Competition

Owing to the high levels of competition for funding, deals, knowledge, and influence within the sector, few US and UK CDFIs collaborate and share information with other CDFIs. If they do, they may only work with other successful CDFIs that operate in the same markets but in different locations. Because of competition for funding, two US CDFIs do not co-ordinate with other CDFIs beyond attending CDFI sector conferences. Only a minority of US and UK CDFIs coordinate regionally and this occurs only if they are not competing for deals or funding. As a result, the US and UK CDFI industry is highly fragmented and competitive despite attempts to alter this by the UK's CDFI trade association, the CDFA and the US CDFI trade association, the OFN. According to the OFN:

> '[what] we are really trying to get people to focus on is taking a sort of strategic thinking…to figure out how to think more intelligently about markets, how to be more focused and disciplined about how they make decisions about what they know and understand about the markets and how to think of themselves as part of a interconnected network of institutions rather than just a bunch of…institutions…I think that the notion prevailing for business model for many years in this industry has been that of a small vertically integrated businesses that you know each exists in their own little world and it's clear that doesn't even really exist

> anymore. People are more interdependent than they like to believe sometimes but be that that silo effect is one of the most troublesome, built barriers to actually being able to be more productive in what we do and so the notion of the network is very much the idea that we are interrelated and interconnected and the more we can sort of leverage some of those interconnections for good, you know to support our work the more effective we'll be in our mission' (5d, US, 12.10.05).

In the future, US and UK CDFIs, may need to co-operate in order to overcome common issues that they find challenging, such as awareness of CDFI activity and deal flow. Despite the significance of local knowledge to address such issues, it is important that CDFIs act together to raise the profile of the sector. With the unstable nature of funding in the US and UK for CDFI activity, it is likely that CDFIs will have to collaborate more and act as a cohesive sector to lobby for financial and political support. Arguably, this is the role of the US and UK CDFI trade associations- the CDFA and OFN. If funding is dramatically reduced in the future, then it is likely that CDFIs will have to consolidate and share resources, change their market or cease operating. As such, CDFIs need to seek business support to ensure that they remain viable businesses in the same way as small firms. Despite the differences in business operations in respect to funding, social enterprises are essentially the same as for-profit businesses as they too occupy a market niche and aim to make a profit/surplus in order for them to survive. The increasing professionalisation of CDFIs could see the US and UK CDFI sector become increasingly more mainstream and this could shift the focus away from the application of a double bottom line to that of a single.

Owing to the intense competition between CDFIs for investment, deals and success, US and UK CDFIs only collaborate with other CDFIs for strategic advantage, such as the sharing of back office systems:

> 'there's obviously some rivalry within the industry but if someone's in direct competition with you then I would say that…there's not a lot of co-operation there' (6b, US, 06.03.06).

This also highlights the lack of trust within the US and UK CDFI sector:

> 'I think what has also made things a little bit difficult and probably more so in recent months has been the fact that all CDFIs are actually bidding in competitive situations for public sector money. In those circumstances the element of trust has to be very great if you are actually going to share your information with everybody else' (8a, UK, 13.01.06).

Off the record information regarding lack of co-operation within the US and UK CDFI industry provided the most interesting findings. The lack of trust within the US and UK CDFI sectors is largely a result of the unstable funding environment. As a result of the competitive funding schemes and loan deals, US and UK CDFIs are wary of collaborating with each other to minimise risk:

> 'to some degree it [is] competitive with some people but…we try to think of it as partnerships and [create] working relationships with different people' (2b, US, 10.02.06).

It is not surprising that some US and UK CDFIs are competitive, especially with CDFIs that are within the same region and/or operate in the same market as themselves. In this way, some US and UK CDFIs are merely replicating mainstream financial practices by being competitive. Further to this, some US CDFIs also compete with other financial institutions for clients and deals:

> ‘there’s competitiveness in the market. Ours is not a pure gap market although there is a pretty substantial capital gap you know we certainly see other people out [there] offering money usually in a different form than ours is but you know its certainly there’ (2e, US, 11.10.05).

Where there are a number of CDFIs operating within the same market and geographical area, there can be competition for clients. As US CDFIs are not lenders of last resort, the level of competition is compounded by banks also vying for loan deals.

Collaboration between CDFIs

CDFI networks serve as opportunities for funding, operational advice, recruitment and client referrals. CDFI networks incorporate every part of the CDFI operational process and span both the public and private spheres. For example, in the US, CDFIs are often in competition with banks for business. The significance of CDFI networks within the US and UK sectors was highlighted in the following way by one of the US CDFIs:

> ‘Well I think [networks] are important in every way, they help referral deals to you and opportunities to you, they help endorse us to others so that the same, you know the same network that if you’re pursuing an opportunity and somebody wants to know who you are and so on,…so you’re whole reputation…and opportunities ride through the network. So the network is critical, always critical … I mean once you’re involved with the company or you’re trying to understand an industry or a market,

> your network again, that's what you use to, you know, pull information from…other than what you find in the abstract world of the net or something, the rest of it is all based in who you know. You know, tell me about this kind of industry, where are its problems, where are its issues, I'm looking for a manager for this lot, how can I find somebody to help me or we need to consult with XYZ so you use your network every day all day' (2e, US, 11.10.05).

The above demonstrates how contacts within a network are used as opportunities to gather strategic information about businesses, markets, referrals and performance. An organization's staff and reputation is also significant within networks, which is also important for creating new contacts and generating new networks. Networks act as a learning tool so that a CDFI can develop best practice whilst also adapting to changing markets so that the balance between economic and social objectives can be sustained. It is important to remember that CDFI networks are time, space, people and price specific. For example, there are time limitations to funding, people are transient, operations are restricted by serving deprived geographical areas and interest rate levels vary according to each CDFI and the market that it serves. The US and UK CDFI funding environment is dynamic and ultimately, it is the funding that controls the operations and markets that CDFIs serve. On this basis, CDFIs can be opportunistic and take advantage of information to use as a mechanism to create opportunities.

CDFIs require a consistent flow of referrals to operate effectively. Bank contacts can act as a referral mechanism and pass on clients to CDFIs that have been rejected for a loan.

This applies more to the UK as US CDFIs are not lenders of last resort. If the loan is approved by a CDFI and eventually repaid, then the client may become bankable in the future and may begin to do business with the mainstream banks that originally referred it to a CDFI. As a result of information sharing, close relationship can reduce time and transaction costs. For example, UK CDFIs can top-up loans from banks when the client lacks collateral to secure the full amount required. A business may require £50,000 but the bank will only lend £40,000, but a CDFI could top-up the transaction by lending the remaining £10,000 required. A close relationship between the bank and the CDFI can reduce the time taken to sanction a loan. A mix of tacit and open knowledge between CDFIs and firms can benefit loan terms and conditions and the relationship banking that CDFIs offer can help overcome information asymmetries. Close relations can also facilitate learning by sharing information and business practices. It could be stated that banks and firms only become involved with CDFIs as and when it suits them. So, by sharing deals and exchanging information, banks and CDFIs could share security, if it is available, but usually the bank will come first. When payments default, CDFIs can restructure loans, write them off straight away or attempt to get the loan repaid through debt collection services. The relationship between CDFI and borrower may be strong at the beginning but can decay as the business begins to fail. Relationship banking and co-operation is, therefore, time limited as the failure of a business to perform often means that there is no dialogue between loan officer and borrower.

CDFIs that have close networks are working together with a shared interest to overcome the barriers faced by the sector. The CDFI trade associations, the US OFN and UK

CDFA, are examples of networks of shared interest. CDFIs only have close links with other CDFIs for strategic advantage. These ties are used to lobby the trade association, state/local and federal/central Government for funding and policy support. This is true of the UK CDFIs that operate in the West Midlands who have formed the Fair Finance Consortium to raise the profile of CDFIs and lobby the RDA and Government for resources. Similarly, CDFI practitioners can influence policy by serving on Government advisory groups. CDFIs exchange information to develop strategic alliances in the sector. By sharing knowledge on regulation for example, legal issues have been overcome as one UK CDFI has suggested:

> ‘there have been occasions where [another UK CDFI has] kind of saved our bacon…over changing their consumer credit license because [one CDFI] said to me, what do you mean you haven’t changed it? It affects [the whole of the UK]…which we didn’t realise because nobody told us, so we had this mad rush to try and change all the loan documents and [they] also helped us out because we charge an admin fee that has to be added into the percentage rate you quote to the customer in terms of PR but our system doesn’t do that. You would have had to do that manually and they had worked out a spreadsheet to calculate that which they sent to us for nothing. So there’s things where we’ve been able to do things for each other for nothing which has been good…and…I was able to give them a bit of information about how we do stuff up here. I have got to say there’s not been a huge amount of transfer in terms of people going down

> and people going up but what there has been has actually been not bad, pretty good' (9c, UK, 10.02.06).

The sharing of information and exchange of knowledge such as at trade association conferences can forge new alliances and ways of thinking and operating which stimulates best practice and increases the quality of CDFI operations and performance. Thus, the exchange of information and business practice helps establish relationships between CDFIs and encourages CDFIs to continue to innovate and develop best practices.

Business innovation, in terms of new or different operations, has led to the exchange of information. By sharing new business practices with other US CDFIs, reciprocal relationships have been developed and arguably, US CDFI performance has improved:

> 'In [this city]…we're kinda the big one - there's some smaller ones that tend to be more either neighbourhood specific or gender specific or in one of the cases that dealt with either more specialised, there's kinda back and forth referrals, a couple of cases joint transactions and…a couple of other CDFIs in [this state] especially that were looking to obtain SBA lending licences since we blazed the trail already…[we] spent some time with them and gave them a stack of documents, cos we just said look we've set the precedent for you now its not like banking competitors, its not the same kinda relationship,…so here's our information,…here's the legal questions, this is what you need this, is what we did to get this licence so its kinda that relationship' (2b, US, 10.02.06).

Yet the exchange of information only occurred because the US CDFIs that were helped were not in competition with each other and this highlights the nature of relationship within the contact networks that have been developed within the US CDFI sector. In addition, case study 2 obtained a banking licence to secure loans using a Government Guarantee (SBA Guarantee), which secures between 75-85% of loans to small firms. In doing so, it could be stated that this commercialises US CDFI practices further. There are also indications that UK CDFIs may also guarantee their lending under the SFLGS in the future.

Networks are also utilized to obtain clients for US and UK CDFIs. Clients are often introduced to US and UK CDFI through bank loan referrals, accountants, business advice agencies, local authorities and agencies, and finance brokers. Referral contacts can be established through associates at previous employers, conferences, and local events. Networking is done by all who work at the CDFI but client referrals are largely via contacts made by the CDFIs loan officers. Loan officers regularly network at access to finance and small business events, and also with contacts at previous employers (i.e. banks); loan officers take the opportunity to update their contact on CDFIs activities and emphasise the significance of referrals. In order to get a continuous flow of deals, the contacts within networks need to be constantly reminded that the CDFIs exists.

Balancing Financial and Social Objectives

US and UK CDFIs are complex organizations that are defined by their missions and operations. CDFIs must try to balance their social and financial objectives throughout the pre-loan, during- loan and post-loan process. Each CDFI has its own definition of the social and financial criteria that it applies and how it resolves the tensions in applying a double bottom line, which may 'never be fully resolved' (Bryson and Buttle, 2005: 278). US and UK CDFIs are constantly challenged by their operations and their missions to fulfil both social and financial objectives which are tied to ethical and environmental objectives. For instance, US and UK CDFIs will not fund 'sin businesses' such as gambling, nor will they support firms that damage the environment. Social objectives are defined as the knock on social welfare benefits associated with creating opportunity and generating employment for specific groups (i.e. women, minority ethnic communities, ex-offenders). Similarly, financial objectives are the perceived advantages of gaining employment and business growth. This research highlighted that the social and financial objectives of US and UK CDFIs are inextricably linked and so the key objectives were jobs created and/or retained, total amount of loans sanctioned and number of loans made. US and UK CDFIs also measured gender and ethnicity. The social and financial objectives are further complicated by the third mission of being independent of funding support and, therefore, sustainable organizations. The implications for CDFIs should they not aim to be sustainable are that they will cease to exist, making their employees redundant, but this contradicts the organization's mission to create and sustain jobs. Therefore, CDFI loan assessment practices 'constrains the [CDFIs] own profitability by restricting opportunities to maximize the return on its capital' (Bryson and Buttle, 2005:279). Here Bryson and Buttle refer to CDFIs profitability when they are not-for-profit organizations. However, they refer to the level of sustainability or surplus accumulated by CDFI activity rather than profit.

A CDFIs social and financial objectives challenge a CDFIs routes to sustainability. There are two types of sustainability: operational sustainability and financial sustainability. Sustainability is defined as ‘the extent to which a CDFI is covering its expenses from its own earned revenue’ (NEF and Nicholson, 2003:41). Financial sustainability is where a CDFI receives enough income from its operations to cover all costs and create a surplus. According to Nicholson (2004:3) there are three ways of measuring financial sustainability, these are:

1. Direct operating costs of lending only.
2. Operating costs plus bad debts.
3. Operating costs plus bad debt plus other overheads.

Operational sustainability is when an organization can cover its operational or administrative costs through its earned income but still requires subsidized capital to on-lend (NEF and Nicholson, 2003). Sustainability is complex as it alters over time with the funding streams and as the client market changes. In addition each individual’s definition of sustainability can be different within a CDFI. Nevertheless, it is clear that CDFIs need to become sustainable as in the long term they may not be able to depend on the support of public funds and private philanthropy. There is no easy or simple way for CDFIs to become sustainable. If CDFIs aim to achieve their financial objectives over their social objectives they may not necessarily become sustainable faster then those CDFIs that prioritise their social objectives as there is no way of knowing which loans will default and how many. Here, the issues of balancing these issues are explored though the loan process.

According to one US CDFI, CDFIs were effectively research and development operations for mainstream financial institutions as this was cheaper than working in such a high risk sector of the market themselves:

> 'what we've done is created a whole industry with public and philanthropic money that does R and D for banks and doesn't get paid for it. Now that's a bit of an exaggeration, but it isn't totally' (7a, US, 07.03.06).

One CDFI highlighted the social and economic conflict in CDFI operations in the following ways:

> 'In the US…compared to the developing world is the high cost of doing business and I don't know if we're ever gonna reach a level of profitability because I think if these loans, if there is a way to make it profitable, I think that banks would have found that out and they would be doing it. There's a reason why they're not doing it simply because there is no money to be made in them and the loan size is too small, the amount of time they would have to invest in maybe doing the due diligence is too much. So I think that's a big challenge for us…[in] that we get to balance doing our mission and you know running a sustainable, effective business at the same time' (4a, US, 17.10.05).

Owing to the high default rates and the time taken to assess loan applications, US and UK CDFI operations are expensive. As a result, CDFIs are presented with huge challenges in balancing social and financial missions whilst also aiming to become sustainable. The success of a business and the ability of the business to secure a loan has been linked to the strength of local networks and whether those networks are embedded in the local economy. The following example reflects the tension between organizations and investors and the significance of embeddedness and balancing social and economic objectives:

> 'one CDFI that we did a job for was set up by the municipality…but…it had a very bad reputation for being connected to the city,…[they] city officials on their board and so on so they were viewed a lot of the time with resentment…but often there's suspicion… in most cities they'll be lots of collaborative committees and things like that and so there'll be a member from every CDFI on it you know they'll be pretty well represented… but it might be that unless there's collaborations that [they] are really successful this kind of resentment builds and negative views of the other and you're only lending in these easy markets, you're not lending in difficult markets and…one of the things I see that if a CDFI isn't doing kind of risky work and really good work, really interesting innovative strategies or if they're just approaching an easy target they're not gonna get foundation [support], they're not gonna get contributor capital and then because they don't get contributor capital they're not gonna have a very interactive product they're just gonna be you know high

> priced and you know so that’s in my mind that’s often how CDFIs separate out, are they able to offer a good product or are they offering a lot of technical assistance to support the risk that they’re taking on, if they’re not doing that they’re not gonna get the contributor capital or the kudos for doing what they’re doing and there just gonna become more and more mainstream because they just have to go for easier and easier markets you know what I mean’ (5a, US, 12.10.06).

This highlights how some CDFIs can begin as project based CDFIs that do not take on risky loans and are simply following the funding to then become increasingly mainstream in their approach. Boards of directors are vital in providing non-financial support in devising a CDFIs strategy, structure, and systems (8g). Younger CDFIs are more likely to be established in response to the introduction of Government support and the development of a number of different business operational models.

Financial Objectives of US and UK CDFIs

The financial objectives of US and UK CDFIs, namely the number of jobs created and/or preserved is one measure the effectiveness of a CDFI’s activities along with other indicators, for example, pre-loan interest rate, post-loan default rate and sustainability level. The loans are assessed on a case by case basis, but largely depend on the number of jobs created and/or retained compared to the size of the loan, for example a £10,000 loan that will retain two employees is more likely to be sanctioned than a £30,000 loan where one job will be created. But the loan application also depends on the market and viability of the business. Interest rates charged by US and UK CDFIs vary widely. The research highlighted that one US CDFI had a concessionary rate of interest due to its social objectives:

> 'Getting grant money [subsidizes our operations and in the future we will]…find… another way of subsidizing it because its never gonna be profitable and we charge instead of 10% then we charge 15-20% then great we are gonna be profitable and its like its not conducive with our mission as we are a not-for-profit organization' (1a, US, 07.10.05).

This particular US CDFI is evidently a policy driven CDFI due to its over reliance on future revenue streams coming from public sources or not-for-profit foundations. In comparison, another CDFI had a higher rate of interest than mainstream banks and the other case studies had interest rates comparable to the banks (Table 5.1, Table 5.2). As another US CDFI suggested, 'It's not pricing that's the issue its access' (7a, US, 07.03.06) that is important in accessing finance. However, this raises questions regarding how high should interest rates go before it is comparable to moneylenders and whether or not a CDFI is taking advantage of its clients in order to become sustainable. The balance between social and financial objectives are contested on a daily basis by US and UK CDFIs, their staff and their board of directors as they develop strategies and assess loan applications. In the case of the US and UK CDFIs that are determined by their missions, the risk-reward ratio is constantly being challenged, whereby depth of reach is balanced against access to finance.

The risk-reward ratio of balancing social and economic objectives is realised in each CDFI loan application. The notion of risk is the chance of the loan defaulting and the reward is the social and financial impact that the loan can make. Each individual application presents a fresh challenge:

> 'we mustn't set up businesses to fail and you've got to take on the riskier businesses so there is a gap between what the banks will do and no one else will do so you're filling that gap but on the other hand you know you have to insist on standards which means you may not help the most needy but you don't necessarily have to have organizations to fail to give them funding if they haven't got a well thought through business plan, if they haven't looked at the market, looked at the competition, so there are some issues there, your mission makes you want to help set up business in a disadvantaged area but you're only creating a bigger problem if you set up businesses to fail' (8f, UK, 20.01.06).

CDFIs need to reach their target market through embedding themselves in the local community whilst recognising the high costs of working in this market. The assessment of loan applications is expensive because it is holistic[23] in its approach as it involves the assessment of both financial and social aspects of the application.

All the US and UK CDFIs in the sample were yet to become operationally sustainable. Some of the US CDFI case studies are said to have attained up to 90% operational sustainability. This suggests that these CDFIs have become increasingly commercial in their lending approach. In addition, sustainability is time specific as a CDFIs level of sustainability fluctuates constantly according to deal flow, write off rate, level of

[23] A holistic approach is when all aspects are dealt with to create a cohesive solution.

guarantee funding, security taken on loans and the current funding situation. Conversely, one UK CDFI stated:

> 'We are a long, long way from that. We're covering about a quarter of our operational sustainability by about 25%. And maybe we don't want to be [sustainable], to reach that level and then that maybe a tip we haven't debated on the board yet, cos this is such too far out of sight but I mean what's the point if you just did like any other bank…our ultimate success is when we've done ourselves out of business' (13a, UK, 13.01.06).

This engages with the issue of sustainability and that some policy driven CDFIs, particularly those that rely on grants to operate should, perhaps, not be sustainable in the long term as this conflicts with CDFIs 'mission' of reaching out to the financially excluded who are high risk clients. Alternatively, CDFIs that have managed their lending to the financially excluded by lending to different loan markets and in that way are balancing their missions and risk-reward ratio. From this it can be suggested that, regardless of their type, US and UK CDFIs continue to rely on public funds and private investment which, in the process, are creating dynamic and complex organizations.

As a result of the risk in lending to deprived communities, US and UK CDFIs are far from becoming financially sustainable. The reliance on grants by some CDFIs, demonstrates the unwillingness to take on debt finance and therefore risk. For other CDFIs, it highlights the lack of understanding of their options and/or their lack of track record. There are barriers to obtaining debt finance for CDFI operations as, just like for-profit businesses they need a proven track record. Sustainability is the goal for many

CDFIs, especially for those that are increasingly commercial in their operations. However, any CDFI may have to adapt their operations to reach sustainability:

> ‘It’s an issue for any business…I think that more mature institutions that have grown have their core businesses…self-sufficient…I think unless [they’re] mature CDFIs the issue is that a) they’re more heavily dependent and this is true of most UK CDFIs, they’re more dependent on donated dollars a and b they don’t understand internal to themselves their financial management…and that’s a common problem. If you don’t have meaningful and effective cost accounting systems and you’re not able to really allocate expenses and revenues in an effective way you don’t actually know what’s going on and so…you can look at the gross numbers but they hide things and every time we think we understand that and we go back and look at the breakout numbers we do internally in self-sufficiency there’s always something that surprises me always, every single time so…’ (5d, US, 12.10.05).

It is likely that many CDFIs that do not respond to the changes in public funding will close or become transformed as they respond to other sources of public funding. For example, those CDFIs that were established as a response to Government funding for CDFIs (largely US and UK third phase CDFIs), tend to shift their markets to follow the funding or follow problem solving policies. In the case of the UK CDFIs that have followed policy and/or project based funding have tended to move towards personal finance in response to UK the Government’s policy shift. In their effort to reach sustainability, CDFIs with their missions at the core of their operations, have to be flexible in their goals so that they can balance their risk-reward ratio in their lending operations. Again, it is important to stress that US and UK CDFIs need to adopt a professional approach to their operations and remain flexible in their goals, just as any other business. In addition, sustainability levels change as to how a CDFI is doing at that specific period in time and even more so given the speed of change in the policy environment.

Social Objectives of US and UK CDFIs

The social objectives of US and UK CDFIs vary widely which highlights the complexity of the organizations, their relationship to the local economy and the level of embeddedness within it (i.e. whether CDFIs are embedded in the local environment). As some CDFIs target specific sectors and markets, each CDFI has different social objectives to fulfil in the loan application process. For example, the number of women or social enterprises for whom a loan has been sanctioned. Nevertheless, the social objectives of all the US and UK CDFIs examined in the study are to create jobs and wealth, in accordance with the core of CDFIs missions:

> ‘clearly the social objectives of [CDFIs] is creating and sustaining jobs and therefore having a real impact upon the deprived parts of [the city] so that’s really important but the only way that you can do that over the medium to long term is to do it on a sustainable basis and particularly in the current climate where ongoing [UK] Government funding and other funding is far from clear so you’ve got to run a CDFI as a business, you’ve got to run it business-like so therefore you’ve got to look at your income

> line, you've got to look at the margins that you're charging, the fees that you're charging. I don't believe that this market is hugely price sensitive, I think its access to finance is more important than the price so I think its very important that all CDFIs look at what rate they are charging, there are one or two that charge soft rates which I think…they've missed the point altogether so this sort of leads us into will they become sustainable in the long term and that's a real challenge' (8h, UK, 05.06.06).

The issues of impact, funding, sustainability, and access to finance raised in this quotation encapsulate CDFI lending activity. The fact that US and UK CDFIs are providing finance to underserved markets highlights the significance of CDFI loans. Moreover, it signifies that US and UK CDFIs, despite their social mission, may have to operate just as any other business would in that they have to consider their financial objectives as well as their social. However, there is a danger that CDFIs are becoming and will become increasingly commercial in their operations if they adopt interest rates at a significantly higher rate than mainstream financial organizations.

The research showed that all US and UK CDFI portfolios had an imbalance between social and financial objectives, which could be a result of the different markets in which the US and UK CDFIs operated. For example, one UK CDFI case study leaned towards social objectives due to the time spent on administering financial advice even to those that did not take on a loan. The CDFI that was fulfilling more social than economic objectives specialised in 'consumption' loans and tended to follow the funding, and this CDFI was, therefore, largely project based. The CDFIs that had a tendency to lean towards commercial viability may become sustainable quicker. These examples may indicate that the CDFIs' social objectives are largely fulfilled through lending to those who cannot access finance from mainstream financial sources. Although in the case of US CDFIs, this is dubious as they are not lenders of last resort and focus on emerging markets therefore this could indicate they are not reaching the truly financially excluded. US and UK CDFIs may need to be more efficient and innovative organizations if they aim to be sustainable and reach their social and financial targets.

This study has shown that it is an enormous challenge to measure social impacts and outcomes effectively to demonstrate accountability to CDFI investors. There is a danger that potential clients and investors could be alienated by the use of banking language in CDFI annual reports and literature. There is a need for a clear message to be projected concerning the activities of CDFIs as they lack of visibility within the communities that they serve. Another reason for lack of visibility is that there is no market for US and UK CDFI activity or the finance gap is marginal. Although this research recognizes that social investment already occurs, it is highly uneven and there is further scope for attracting further investment into US and UK CDFIs. Perhaps the lack of consistency in performance measurement and fragmentation within the US and UK CDFI sectors exacerbates tensions and competition between CDFIs. This could impact upon the effectiveness of US and UK CDFIs to operate and their ability to attract investment.

Performance Measurement

Performance measurement is a tool to see how well an organization is doing and what if anything is going wrong (Law, 1994). CDFI performance measurement essentially assesses the key objectives of the CDFI and how these can be improved. US and UK CDFI performance is often measured in terms of the default rate or the percentage of loans sanctioned that have not been repaid. The default rate is measured as the percentage of clients that have failed to repay their loans on time. It can be measured over different time periods (i.e. annually, since inception), in different markets or combinations of markets, or a combination of both to demonstrate performance. US and UK CDFIs are unregulated and so are able to adjust the figures according to whichever calculation reflects best on their performance. Such practices call into question the appropriateness of performance measures and whether they can be standardized to reflect US and UK CDFI practices and activities. However, the definition of default and sustainability changes over time and according to each individual within each CDFI. Thus sustainability is a slippery concept as it is linked to a CDFI's core mission and operating style. The following shows the difference in how UK CDFIs balance their portfolio according to their missions and sustainability objectives:

> 'I think if [our default rate] get[s] below 20% then we stand open maybe to the criticism that we are being too selective but were in danger of being squeezed, I think, in that if were not selective enough we [will not] be sustainable so it's a bit of a tight rope to walk' (8d, UK, 13.01.06).

Another UK CDFI argued that:

> '[Our sustainability rate is] just a bit over 60%, I think, just now. And it also depends on how you look at the figures and how brutal you are and what your default rate is and how you write off and, I mean, we write off very brutally at the moment, we write off after three missed payments. So our default rate is really high. But if we take it what … happens after we get recoveries, we would maybe get them back paying again, then that takes a lot of the way down. It's difficult to compare because everybody does it in a slightly different way and also, do you take it over your whole loan portfolio or do you take it over a year, do you know what I mean? It's difficult,…because most of us have had no training…all our lending is unsecured, which is pretty unusual for a CDFI that does business loans…we do take personal guarantees but a lot of people don't consider that as security, because they are only worth what they're worth when you are able to pursue them. But that would cover 75% of loss which would be good for us because we could cover the other 25%. But if we couldn't get small firms and we couldn't get other money then we're bust because we can't cover the level of debt on the percentage rate that we charge. We would have to be charging 25% or something' (9c, UK, 10.02.06).

The annual data gathered by the US and UK CDFI trade associations also have limited validity as a result of them combining data from older and younger CDFIs, so the figures are not truly representative of the US and UK CDFI sectors. There are moves by the UK's CDFA to try and address the issue of performance measurement by setting benchmarks through SMILE, 'a financial, organizational and impact monitoring tool' to assess finance, operations and the impact of UK CDFIs (CDFA, 2007). However, there are questions concerning standardization given the complexity and diversity of the UK CDFI sectors many different business models and the regulation of the measurements as each CDFI is responsible for calculating its own performance.

US and UK CDFIs have demonstrated that the risk reward ratio of lending to financially excluded businesses can be uneven. Lending to financially excluded businesses and individuals is high risk and a CDFI may never be sustainable. Yet arguably, US and UK CDFIs have made some businesses bankable after banks had refused them credit. The research suggested that banks could either pull back even further to increase the finance gap, or in the UK, take on CDFIs themselves in the future. However, the latter may be unlikely as:

> 'what bits the UK banks don't do are the scraps and those deals really aren't very strong and I think its been proved…that doing start-up lending is extremely risky…we've then got the demand, is there sufficient demand out there other than what the banks are doing so you know is there much left over?' (8h, UK, 05.06.06).

In this way, it is not surprising to learn that banks would not be willing to take over UK CDFI operations at the present time, unless for example, they were driven to by the UK Government as part of CSR:

> 'It all comes down to the size of the market and I suppose the more consolidation you had particularly on back office and stuff like that, you see CDFIs could end up looking like banks…30 years ago before they

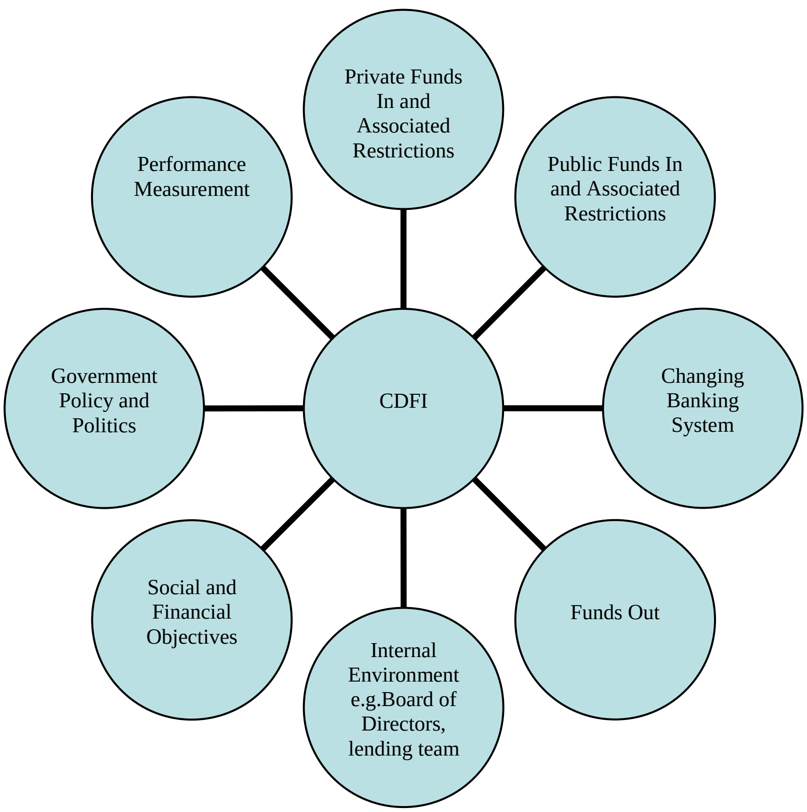
> started using credit scoring techniques and things like that and you know lots and lots of paper work…to do individual deals so I think they need to think about how they can share back office stuff like this, become much more streamlined, so no I don't think banks will take over CDFIs not in the short to medium term' (8h, UK, 05.06.06).

This statement is significant in that CDFIs are seen as clearing up the excess of the economy, when in reality they are giving those living in disadvantaged areas the opportunity to make a living for themselves and their community. UK CDFIs will continue to consolidate their operations, which has begun through the sharing of back office services. On this basis, US and UK CDFIs are operating on a local level, relying on local knowledge to determine their market, just as banks once did prior to the introduction of credit scoring. Moreover, CDFIs could be seen as replacing banks as CDFIs are undertaking smaller loans that banks do not take on and CDFIs are located in disadvantaged areas and it is these areas in which the banks have withdrawn their services via the rationalisation of the branch networks.

Balancing Complexity and Dynamism

US and UK CDFIs can be characterized by dynamic complexity. There are different dimensions of complexity, for example funding streams and the restrictions and politics associated to them, and these dimensions are dynamic as they change over time and space. CDFIs are complex owing to the embeddedness of their operations, which are constrained by the geography and flows into and out of the organization. Within the lending process there is also temporary complexity as lending committees balance the risk and reward of each loan alongside the CDFIs strategy. As the balance between the financial and social objectives has to be maintained and the flows into, within and out of each CDFI are ever changing along with the political environment and banking system, CDFIs are dynamic and flexible organizations which respond to and instigate change depending on their strategy and operating style (Figure 6.4). It could be argued that some US and UK CDFIs are experiencing controlled, sustainable failure. For example, in the UK, CDFIs are at the lending edge of the New Labour Governments agenda of inclusion through responsible capitalism. The logic for this approach is that the grants made to UK CDFIs under the Phoenix Fund were cheaper than welfare payments.

Figure 6.4: Dimensions of Complexity within CDFI Operations



(Source: Own research)

Conclusions

This chapter first explored the flow of funds into US and UK CDFI via banks, not-for-profit foundations, the public sector and private investors and presented the challenges that this caused US and UK CDFIs. The second part of the chapter explored the US and UK CDFI operating environment which established that there are two types of CDFI; policy based and diverse. Each of these types also have subsets; policy based CDFIs can include project based and/or balanced CDFIs, whilst diverse CDFIs can also include balanced CDFIs. The third part of the chapter explored the flows out of US and UK CDFIs through the loans made, interest rates, default rates, performance measurement, social and financial objectives and operational and financial sustainability. The final part of the chapter explored if and how US and UK CDFIs can balance their performance through their portfolio and their missions. To this end, US and UK CDFIs are complex organizations that have to constantly adapt to their changing operating environment for them to survive.

CDFIs are characterized by dynamic complexity. CDFIs are helping to bridge the finance gap. Yet they are an intermediary development tool, grooming clients to become part of the mainstream system through helping them acquire a financial track record, delivering financial education, business support and finance to financially excluded firms. As a result, CDFIs emerged as an alternative to mainstream finance yet now are becoming increasingly conventional institutions operating within a niche market. Furthermore, CDFIs have developed in one of three ways. First, some CDFIs follow Government funding sources to determine their markets and operations. Second, other

CDFIs have become increasingly commercial to fulfil their objective of becoming financially sustainable and thirdly, there are CDFIs that try to balance their social and financial objectives. In this way, US CDFIs are not as mature as they are widely perceived to be by UK CDFIs, thus sustainability remains an issue for all CDFIs, just like any other small business. Therefore, in the future, it is essential that CDFIs in the US and UK develop efficient economies of scale and grow through diversification, scale or merge. The costs of operating could be reduced if CDFIs centralized their back offices and had satellite offices. On this basis, CDFI activity could be seen to be closing the US and UK finance gap for enterprises. Yet many enterprises remain excluded from accessing debt finance, particularly start-up and micro enterprises operating in disadvantaged communities. In addition, as a result of their networks and role, CDFIs are part of the financial system as they are becoming increasingly commercial in order to survive. In this way, some CDFIs operate largely in the same way as mainstream institutions, by fulfilling a single bottom line, perhaps more so than they would like to realise.

US and UK CDFI networks are shaped by the funding support that they receive and the markets that they serve. On this basis, funding and markets could be the key drivers of CDFIs as they inform their organizational strategy and future. These networks are also shaped by spatial proximity and time as these factors influence the strength and weakness of ties within each of the US and UK CDFI's operations. The reliance on public funds and private investment means that CDFIs are dynamic organizations that are largely unsustainable in the short to medium term.

In conclusion, US and UK CDFIs are not operating in a purely alternative fashion as CDFIs integrate the blended values of social and financial objectives and incorporate mainstream banking practices into their operations. As such, many US and UK CDFIs are diverse organizations that have developed in response to Government policy as a vehicle for small firms to access finance. The next chapter will explore the conflicting nature of the CDFI double bottom line through the analysis of CDFI activity in the West Midlands, UK.

CHAPTER 7 WEST MIDLANDS CDFIS IN CONTEXT AND THE CASE OF THE ASTON REINVESTMENT TRUST

This thesis has so far explored the diversity and complexity of US and UK CDFIs, in particular, the policy background, tempestuous funding environment and the significance of time. This chapter explores CDFIs in the regional context of the West Midlands, UK, through the example of ART. The chapter is based on eight interviews with representatives from ART that were undertaken in 2006. These interviews included five members of the board, two loan officers and the Chief Executive, and produced nearly 40,000 words of transcript. Some interviews were incredibly valuable and contained important information. The board members and Chief Executive were able to discuss strategy, while interviews with loan officers explored daily implementation of policy. The chapter draws heavily on two of these interviews, but triangulation was undertaken between these two interviews and the others. The CASE studentship facilitated unusual access to strategic members of the ART team and reflects a period of three years engagement with an organization. The UK's West Midlands region comprises the counties of the West Midlands, Shropshire, Staffordshire, Warwickshire, Worcestershire and Herefordshire.

The first part of the chapter outlines the regional context of CDFIs through the geographical debates surrounding charity, access to finance and uneven development. The second part of the chapter explores the bottom line of CDFI operations, which could be seen as the foundations of CDFIs missions and operations. In light of this, the third part of the chapter explores ART, a West Midland CDFI, in terms of how and why it was established, the nature of its operations including the sources and uses of funds, ART's board of directors and clients. The final part of the chapter highlights the dynamics within and between UK CDFIs through the concept of complexity.

West Midlands Context

The West Midlands has an enterprise deficit in relation to other regions of the UK (Deloitte and Touche, 2002: AWM, 2004) as the birth rate and growth of SMEs within the West Midlands is below the national average. The RDA, AWM is addressing issues of finance for enterprise by identifying market gaps and implementing strategies to overcome them. The importance of West Midlands CDFIs is highlighted in the following statement:

> '[CDFIs] are important to the West Midlands both as a sector in their own right (as part of the broader social economy) and also in playing a key role in ensuring that the economic growth and development of the region benefits all the population and areas. They can help to join up the economic, environmental and the social through their activities, provide new models for service delivery and underpin competitiveness and employment creation. They are therefore part of business and sectoral strategies as well as regeneration plans' (NEF *et al*. 2003:10).

AWM works closely with CDFIs in the region, and it can be suggested that the West Midlands is leading the way in terms of the exchange of information and support between CDFIs and RDAs. In support of this, AWM has attempted to 'improve the performance of existing financial instruments and resources' by identifying and bridging the finance gaps for SMEs, by coordinating financial resources in the West Midlands (AWM, 2004:125). Of all the English RDAs, AWM is leading the Access to Finance agenda by addressing the issue through consultation and by implementing strategies to overcome barriers to finance such as creating networks to exchange information, and share opportunities for investment. In 2005, AWM, with Barclays bank, supported the creation of the New Consortium for the West Midlands (CDF-WM)[24], a consortium of CDFIs and other loan providers in the West Midlands which could help AWM to achieve its own policy objectives. AWM have developed the ASLP which is designed specifically for CDFIs supporting enterprise and other loan providers to access capital and/or revenue for their operations and is designed to act as a follow on from the Phoenix Fund. AWM is unique in its approach to CDFI support in terms of funding and networks. CDFIs and other loan providers located within the West Midlands do not cover the entire region, although the CDFI geographical coverage, compared to other regions in the UK, is widespread (Figure 7.1). However, the West Midlands CDFIs do not operate in the same markets. This means that access to certain products and services is also uneven. There are eight CDFIs in the West Midlands operating in a variety of markets and serving both urban and rural populations. The West Midlands CDFIs are:

- *3b*
- ART
- *Black Country Reinvestment Society* (BCRS)
- *Coventry and Warwickshire Reinvestment Trust* (CWRT)
- *Impetus*

[24] CDF-WM changed it's name to Fair Finance Consortium in 2005 to increase awareness of the sector.

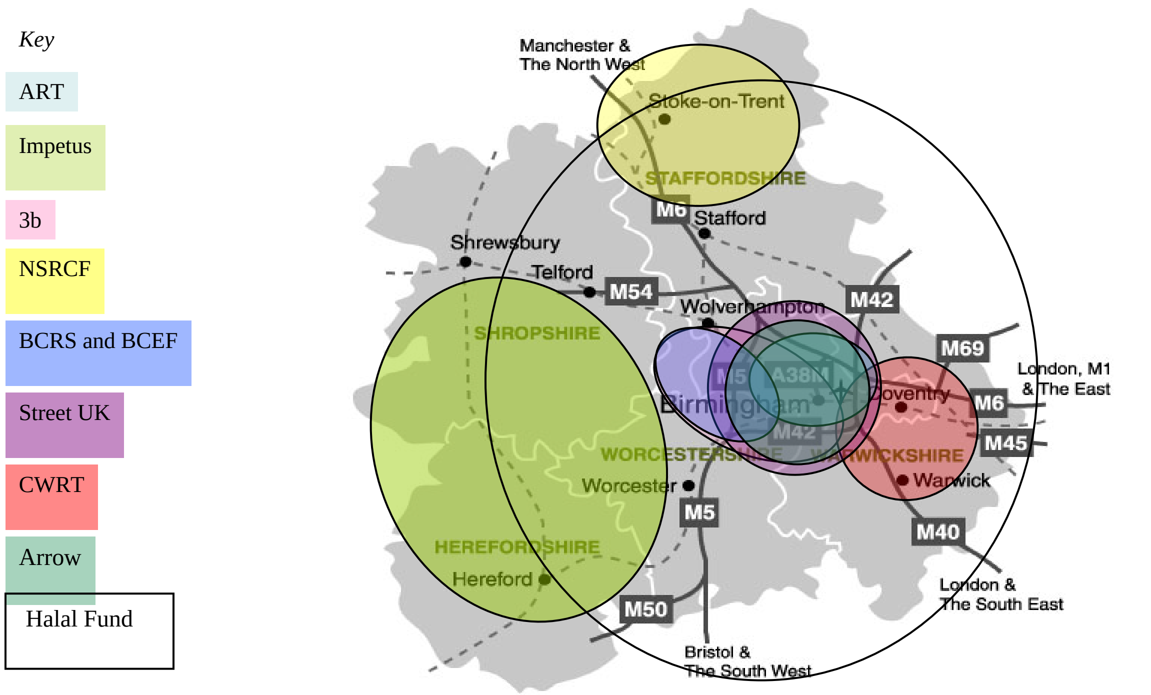
- *North Staffs Risk Capital Fund* (NSRCF)
- Street UK
- *The Halal Fund*

There are also several other loan providers in the region, including:

- *The Arrow Fund*[25]
- *Black Country Enterprise Fund* (BCEF)

The West Midlands is a suitable case study to explore the complex nature of CDFIs.

Figure 7.1: CDFIs within the West Midlands, UK



(Source: Adapted from AWM, 2005: No page number)

- [25] Is another loan model and member of the Fair Finance Consortium but is a guarantee fund that uses a bank as the lender.

Uneven Access to Finance

A finance gap exists in the supply and demand of loan finance (BOE, 2002; Bolton, 1971; Macmillan, 1931; Radcliffe; 1959; Storey, 1994; Wilson, 1979) and is particularly prevalent in disadvantaged areas (Mayo *et al*. 1998), to the extent that ‘there is a systemic development of the geography of financial exclusion in the UK’ (Bryson and Buttle, 2005:286). With the availability of funds from the UK Government support under the Phoenix Fund, it was assumed that as an alternative vehicle of finance, CDFIs would help to resolve the issue of financial exclusion of enterprise from commercial sources of finance. It is ironic then that as with their customers, CDFIs and charities can experience financial exclusion, as information asymmetries exist between CDFIs and mainstream financial institutions. This makes it challenging for them to secure finance other than grants and charitable donations for their operations (Bryson and Buttle, 2005).

CDFIs, like charities, are part of the third sector, defined by their actions and operate for specific groups and/or purposes on a not-for-profit distribution[26] (Butler and Wilson, 1990; Bryson *et al*. 2002). The long history of charity is complex due to its diversity (Bryson *et al*. 2002). However, according to Beveridge (1948) there are just two types of philanthropy, first, there is the desire to meet need or combat a particular evil and, second, there is a need to alleviate poverty. Woodroofe (1962:23) suggested that charity could be a ‘social regenerator’ and that it could be used to initiate self-help. These comments on charity could also be likened to CDFI activity as CDFIs aim to relieve poverty through enterprise. CDFIs like charities, are also complex in the way that they

[26] Any surplus is distributed back into the business rather than shareholders, thus CDFIs are non-profit distributing.

are defined and through their operational models. They can be an IPS, Banks, Companies Limited by Guarantee and also registered for charitable purposes (Bryson and Buttle, 2005). The historical background, contextual environment, and organizational aims inform the charities strategy and structure (Butler and Wilson, 1990). The organizations board of directors and individuals volunteer their services to the third sector 'to supplement what is done as social service by the state' (Beveridge, 1948: 125). In this way, 'altruism is a fundamental part of human rationality' and essential to voluntary action (Butler and Wilson, 1990:1). Therefore, the motivation of boards members can be a result of philanthropic idealism.

Geography of West Midlands CDFIs

Uneven development is recognized as the lack of access to finance in disadvantaged areas, which in the UK, has been exacerbated by the rationalisation of bank branches that began during the 1980s (Harvey, 1973; Leyshon and Thrift, 1994; 1995; 1997; Martin, 1999). CDFIs were the 'new animal' by which poverty was to be relieved (8a, 13.01.06). However, there is an accumulation of charities in areas of wealth, creating a disconnect between areas in need and areas of wealth. For example, the coverage of CDFIs in the West Midlands is uneven due to the establishment process, which created spatial gaps in the provision of finance for enterprise. The geography of CDFI activity is uneven making access a key issue and the formation of a CDFI is based upon the actions of a set of individuals trying to solve a local problem. Thus, CDFI coverage is not planned but evolves as individuals create local CDFIs.

Currently there is uneven development of CDFI operations across the West Midlands and the UK (Figure 7.1). Bryson and Taylor (2006:34) state that ‘compared to other UK regions, CDFI coverage in the West Midlands is relatively widespread’, yet gaps remain in market provision and with geographical areas served. The RDA recognize this:

> ‘[AWM] has provided some initial support to CDFIs under the Advantage Small Loan Programme but acknowledges that there are still gaps in the provision of this type of finance both in terms of geography and levels of finance (under £10k). It also wants to review the prospects for the long term provision of this type of finance. This links to issues over the sustainability of individual CDFIs and need for ongoing public sector support. It is, therefore, intending to commission some research/consultancy to examine these issues and provide it with recommendations on the way forward’ (15a, UK, 29.06.06).

It is encouraging that AWM continues to assist CDFIs in the region and is trying to identify the best way to support them and to ensure that they meet their policy objectives. To achieve scale and geographical coverage, ART and other CDFIs would need additional resources which include funding, people (staff and boards of directors with the right combination of skills and expertise). However, in increasing the scale of CDFI operations, there is a conflict between resources and sustainability.

Not only are there gaps in the geography and levels of finance that CDFIs provide but staff with appropriate knowledge and skills is also in short supply. For example, ART has employed ex-banking staff that possesses the right knowledge and expertise associated with enterprise lending and operations. The geography of CDFIs is:

> 'affected by the availability of the right combination of individuals with the relevant skills, knowledges and experiences' (Bryson and Buttle, 2005:284).

Combining both social and financial knowledge and skills in one person is rare (Bryson and Buttle, 2005). The geography and impact of CDFI provision on local economies will therefore be highly uneven.

CDFI expansion in the West Midlands is, at present, restricted by other CDFI activity and funding restrictions. It has been suggested that the future of CDFIs depends on finding cheaper ways of administering loans, whilst remaining true to their mission. As one ART board member remarked:

> 'ART is limited by it's geographical boundaries at the moment and in the future, particularly if some of the CDFIs that are suffering. [There] may be a way forward in having a satellite office in Leicester, or Nottingham or wherever. That would be fantastic really….you can always franchise out a successful model and I think ART and DSL [Developing Strathclyde, a Glasgow based CDFI] and Bolton [Business Ventures] are successful models and if you can then franchise out that concept rather than set up something new from scratch which has to go through all the learning and audit committees and boards and this and that. If you can avoid that by

> setting up a simple franchise where the Governance is provided from the centre it would be a lot easier to do' (8f, UK, 20.01.06).

There are cases of CDFI duplicating other successful business models, but it is not a guaranteed way of providing access to finance as the CDFI has to become locally embedded to have local knowledge, understand the market and the needs of their borrowers. The business model could be transferred and should work the issue is obtaining clients.

Merging CDFI operations regionally would be cost effective. Although a West Midlands merger would have to be time and space specific, for example, CDFIs would be at risk of closing. With the closure of the Phoenix Fund, and the problems of raising additional capital via CITR, some CDFIs are shifting their markets, products and services into other sectors such as personal consumption finance:

> 'There are massive problems facing the sector with the removal of [the] Phoenix Fund support and…there is going to be no reason for them to continue to exist and if they think they are gonna go into personal debt I don't think there is a [finance] gap [in personal finance], I think the credit unions are there to do it and I would really like to see credit unions expand more and more successfully in this country and there's some great examples around…airline pilots, and taxi drivers…and [the UK is] moving towards what Ireland and America have got and it's on the cusp of the credit union movement and it also has a massive social function of reaching the unfinanced but I think if the CDFIs move into that then it's

> because they are looking for a reason to exist rather than filling a gap' (8f, UK, 20.01.06).

Thus, following available funding and shifting markets jeopardizes CDFI's validity and reputation as they fail to develop a clear place in the market and are not fulfilling their original goals. The opportunity to merge CDFI operations would be:

- If and when no further funding is allocated to CDFI operations,
- To concentrate to finance for enterprise (SMEs and social enterprise),
- To create a more cohesive sector,
- To increase awareness of CDFIs and raise their profile to attract target clients, and retain their niche in the finance market,
- To improve accountability.

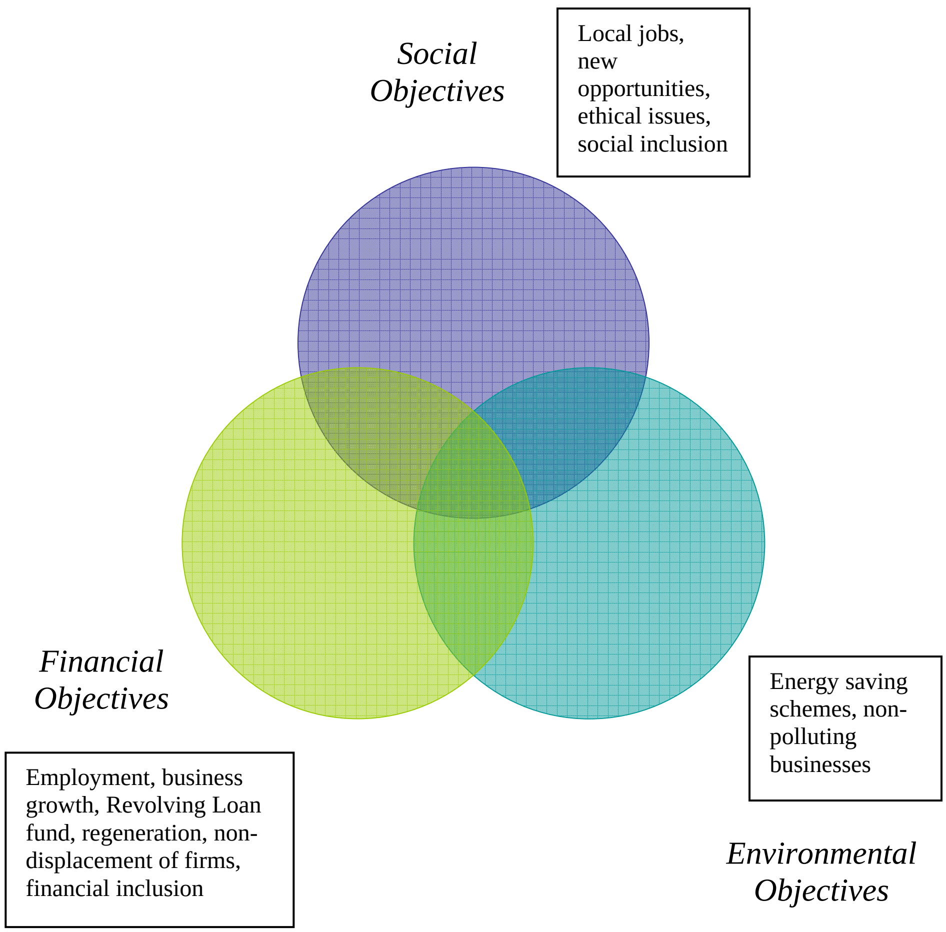
A merger would be time and space specific as firms, regardless of whether they are for-profit or not-for-profit. The UK CDFI sector has changed rapidly, especially since this research was begun. UK CDFIs are in a transition period in terms of funding. There is as yet, no final decision regarding the way in which CDFIs will be funded in the future, if at all. Some RDAs have contracted the strongest CDFI in its region or created a consortium to carry forward the work. Currently, it does not appear that UK RDAs are ready to provide a long term commitment or solution to their local CDFI. There are a number of different models being trialed in the various RDAs, for example hub and spoke, mostly using the last tranch of Phoenix Fund monies. Thus CDFIs could become programmes or project organizations which render the CDFA's performance and benchmarking agenda obsolete. Arguably this is creating further uneven development of markets and sectors served by CDFIs. The UK CDFI sector is enduring a period of uncertainty. Without collaboration and co-operation from other financial institutions, business support and banks it is unlikely that CDFIs will ‘ever constitute a comprehensive and systematic tool for combating [financial] exclusion’ (Bryson and Buttle, 2005: 286).

The double bottom line is central to any definition of a CDFI. However, this thesis will contend that CDFIs are, in fact, working to a triple bottom line. This triple bottom line adds environmental objectives alongside social and financial. Owing to the nature of CDFI operations, there is an overlap of these issues and environmental issues are often alluded to but are not yet a mainstream part of their business. The key to this argument is that CDFIs have numerous values in which they articulate in their lending operations. This adds another dimension of complexity to CDFI operations, yet it could be argued that by categorizing CDFI activity in this way their operations are simplified. This is because CDFI objectives create the foundations for its action.

Triple Bottom Line

Throughout this thesis, the dynamics of US and UK CDFI activity have been explored which has reflected the diversity and complexity of their operations. At the core of CDFI operations is the double bottom line. However, as the research shows, it is evident that CDFIs realize more than just social and financial objectives. Within the concepts of social and financial objectives are a whole host of other, hidden aims which are specific to each particular CDFI. These values may or may not be explicit to those working within the CDFI or in the board of directors and may be viewed as a given depending on one's beliefs and/or view. As these objectives are at the core of CDFI operations, it could be stated that these define and determine the organization.

Figure 7.2: Diagram to Show US and UK CDFI Triple Bottom Line



(Source: Own research)

The triple bottom line represents further complexity that is inherent in CDFI operations (Figure 7.2). Each circle represents the social, financial and environmental objectives of CDFIs. In each objective lies a set of values. It is these values which influence and provide the complexity within CDFI operations, particularly the loan decision process.

The financial objectives are to: financial inclusion through employment and access to finance, help businesses to grow and/or diversify, regenerate the local area, whilst creating a revolving loan fund for the CDFI to continue operating. The social objectives of CDFIs include: actively promoting social inclusion by creating or retaining local jobs, new opportunities, through practicing ethically for example, through the non-displacement of firms and manageable levels of credit. Ethical objectives could be added to the CDFI set of objectives. Acting ethically is arguably already a key element of each set of objectives. The environmental objectives are typified by lending to a specific geographical area, businesses that produce and consume products in the locality, businesses that reduce energy emissions, and/or promote environmentally friendly practices such as recycling, refurbishing or reusing goods. These objectives are all intricately linked which makes it hard to separate them into discrete issues. CDFI operations, the loan application process and performance measurement remains a challenge for each CDFI. The interrelated nature of social and economic criteria is the reason why the boundaries of these concepts are blurred and that CDFIs are diverse and complex organizations.

The triple bottom line is balanced at the central intersection. But balance between the objectives of CDFIs cannot always be made. This is due to restrictions placed on the funding. The board ensures that lending restrictions filter into the lending decisions. The lending restrictions depend on the source of funds, the time, geography and market restrictions placed upon it. For example, ASLP funding does not include loans for retail as it is against the original remit as part of the funding came from the *European*

Development Regeneration Funding (EDRF) Objective 2. Even if funding has ended, the restrictions placed on the funds can continue if the CDFI should choose to do so (as the money becomes theirs to either guarantee the loans or use for revenue) and re-lend that money for that specific purpose within certain areas. External and internal (self-imposed) restrictions are blended into a short and long-term strategy and heavily influence the lending process. Bryson and Buttle (2005) did not consider the restrictions that CDFIs face imposed by providers of funds. The internal and external restrictions are part of the ethics of CDFI operations. The self-imposed geography of lending in key areas is especially important in policy funds. In many cases, after funds have been re-allocated for a specific purpose the CDFIs do not retain a separate allocation in their accounts to explain future uses which complicates performance measurement. Those CDFIs that have continued to place restrictions on funds can suffer from constrained hypothecation, meaning that their CDFI may be experiencing controlled failure, as a way of fulfilling their social and ethical missions rather than their financial objectives.

The triple bottom line will be explored further in the ART case study to show how intricately linked the social, financial and environmental objectives of CDFIs are. The following section will highlight how and why ART was established, the sources and uses of its funds, the board of directors at ART, its organizational strategy and finally ART's active clients.

The Aston Reinvestment Trust (ART)

ART was established in 1997, during the second phase of UK CDFIs, as an independent social financial institution to provide finance for enterprise. The founders of ART were 'a unique collection of individuals, all with long-term interests in maintaining Birmingham's local economy and in providing local jobs for local people' (Bryson and Buttle, 2005:285). The leading individuals that established ART were Sir Adrian Cadbury, Pat Conaty (who was then Development Manager of *Birmingham Settlement*, Vice Chair of *UK Social Investment Forum* (UKSIF), and also later helped to develop *London Rebuilding Society* and *Wessex Reinvestment Trust*), Danyal Sattar (who was secretary of UKSIF and also later worked for the *New Economics Foundation* (NEF), *International Association of Investors in the Social Economy* (INAISE), Charity Bank and *Esmee Fairbairn Foundation*). From this it is evident that ART's architects were visionaries. Undoubtedly, the key influences of ART were the US CDLFs. It could even be suggested that the founders of ART influenced a new paradigm of social finance in the UK through the use of a revolving loan fund purely for enterprise in disadvantaged areas. ART inspired many others to imitate its model and helped to persuade the Labour Government to support UK CDFIs as part of their financial and social inclusion agenda. In many ways, ART was ahead of the rest of the CDFI sector as they were the first UK organization to use social investment raised from individuals which was to be invested locally in enterprise in Birmingham.

The core strategy of ART is 'to provide loans for viable small businesses and social enterprises…when banks are unable to help or have done all they can' (ART, 2006:1).

ART's loan fund was launched in June 1997 after a six year period of consultation and development. ART operates a revolving loan fund, so as loans are sanctioned and repaid, the funds can then be recycled and lent on to other clients. ART provides finance for enterprise (micro-enterprise, SME and social enterprise) in Birmingham and North Solihull. ART initially provided loans to micro enterprise and SMEs from £2,000 to £40,000 and then moved on from April 2006 to provide loans in the SME market from £10,000 to £50,000, targeting the whole of Birmingham and North Solihull. ART also used to provide finance for individuals to refurbish homes under the ART Homes[27] scheme and finance for energy reduction under ART Energy. These schemes confused the ART brand and the decision was made to focus on the core objective of providing finance for enterprise. ART Homes and ART Energy pilots were subsequently removed from ART. Mercian Housing who took over ART Homes has overtaken the total amount that ART has made in loans (as of September 2006) as ART Homes now has a national focus rather than local.

As ART was founded prior to the Phoenix Fund, funding for ART's capital was obtained through social investment (with a social return) from corporate, public and private investors. This investment was then used to leverage additional funds from banks, charitable foundations and trusts so that ART could build its portfolio and be independent of public funds. ART made careful use of their policy guarantee funds at an early stage from the public sector. ARTs first year business plan was to raise £500,000 in capital and lend £200,000. This meant that £40,000 (20%) had to be raised came from charitable donations that were used to underwrite the risk. In reality, capital of £360,000 was raised

[27] ART Homes was a capital release programme for asset rich and revenue poor.

from private sources plus £140,000 was raised from public sources. The public funds became guarantee funds and were used to leverage private funding. ART has tried to obtain 20% of risk capital to underwrite the risk but public funds have given up to 70% at times. ART's revenue capital was initially 90% from the private sector (Barclays bank, Natwest bank, *Charities Aid Foundation* and *Birmingham City Council*). In this way, ART aimed to move towards sustainability from the outset. Funds obtained from the UK Government's Phoenix Fund have allowed ART (and other UK CDFIs) to fulfil their role within the sector and provide the market with alternative finance by increasing scale and reach, and enabled them to take on additional risk in their lending activity which may have compromised their aims and increased the levels of bad debt. By taking additional risk, ART has fulfilled its role in lending to those who are not able to obtain their full requirements from other sources while remaining true to its mission of supporting local jobs for local people. ART is reaching its target market and successfully achieving its social and financial objectives.

ART's operational model was inspired by the success of US CDFIs and ART, too, has been replicated by a number of other UK CDFIs (such as *South Coast Moneyline* formerly *Portsmouth Area Regeneration Trust*) often helped by ART's staff and board members. For example, Bert Nicholson, a former board director at ART and an economic development consultant, acted as an independent consultant, rather than as a member of the ART board, to help establish BCRS and CWRT, and Steve Walker acted as the mentor to the Chief Executive of Street UK. Some of whom have moved towards serving personal sector debt over enterprise. From this, it may be stated that these UK

CDFIs appear to be largely policy driven, project based CDFIs that follow the funding and tailor their products and services accordingly perhaps to the disadvantage of their missions and/or market. In the early stages, organizations need to focus on their objectives so that they can operate with integrity. CDFIs are designed to be a flexible vehicle to supply finance to deprived areas, yet those CDFIs that are project based can jeopardize the CDFI and the sector's reputation and sustainability especially if they frequently switch markets and adapt their operations to the latest funding initiative.

Sources of Funds

ART has received major funding from the Phoenix Fund and ASLP. ART has received financial support by way of loans, grants and donations from sources such as the Esmee Fairbairn Foundation, and Tudor Trust. Investors include; *Jaguar*, *IMI*, *Severn Trent Water*, *Wesleyan Assurance Society*, Natwest bank, Barclays bank, *West Bromwich Building Society*, Sir Adrian Cadbury, Sir Richard Knowles (former Lord Mayor of Birmingham), Sir Digby Jones (former Director-General of the Confederation of British Industry) and a number of other individual and corporate shareholders. Members can invest between £250 and £20,000 and receive a social return rather than a financial return.

ART is also Community Investment Tax Relief (CITR) accredited.

> 'CITR offers 5% per annum off personal or corporate tax liabilities up to a maximum of 5 years. Full CITR offers a return of 5.3% to a standard rate tax payer' (ART, 2007a:1).

Shareholder investors are part of the mutual society based on the remit of the IPS guidelines. The variety of funding that ART receives ensures that it does not rely on one source or type, for example, public sources. Owing to the high profile of some of ART's investors, they can benefit from their networks and the power they have to influence other key figures in Government and industry. As Butler and Wilson (1990:16) state:

> 'a voluntary organization that can choose the level of Government financial support is far less dependent and far less subject to possible constraints on its autonomy than those organizations which rely upon substantial Government funding'.

This alludes to the notion that CDFIs should aim to be independent and sustainable in the long term. It had been hoped that CDFIs would develop along these lines, but the vast majority of CDFIs have failed to take this approach and continue to rely heavily on UK Government grants.

Operations: Uses of Funds

ART offers finance from £10,000 and has recently increased its maximum loan size from £40,000 to £50,000. This strategic decision was intended to shift ART away from deals below £10,000 which had been high risk and not cost effective, also in response to the changing market needs. Micro enterprise accounts for over 60% of ARTs portfolio, and start-ups 50%. It was originally envisaged that social enterprise loans would help to balance the risk of lending to small businesses. Social enterprise loans have been slow to materialize but now account for just under 18%, out of a total portfolio of £5.6 million or £1 million worth of loans to the sector. ART has a bad debt rate of 22.6%, which is similar to the SFLG default rate. In 2005, ART initiated ART development services, a pilot scheme funded by the DTI to administer post-loan support. ART believes that by providing business support, the risk of loan default will be reduced and will increase the success of the businesses that it assists. ART has also developed a CD-ROM which is designed to guide entrepreneurs in setting up their own business. The development and modifications to the ART business model demonstrate that CDFIs are innovative and flexible financial instruments that can be effective in reaching financially excluded firms that are on the commercial margins.

ART Board of Director Dynamics

The board of directors plays a fundamental role in the management, operations and strategy of organizations. In addition, the way in which the board of directors is established is significant, especially how and why certain individuals become board members, i.e. through particular networks. The nature and composition of a CDFI board, such as ART's, can be explored through a number of questions: how and why was the CDFI established; how was the board established; who were the original board members; who are the current board members; what were/are the original/current board members roles inside and outside of the organization; why were these people selected as board members. Board member recruitment at ART relies on established business and relationship networks to identify potential candidates. The mechanism for joining the board is through social vetting at a CDFI social event where the potential candidate may not even know that they are being vetted. If the candidate is successful and asked to join the board, the new board member has to prove themselves and become an active participant in the CDFI. The sequence of events leading up to and following recruitment is exemplified in the following instance of requirement to the ART board: first the person concerned had contact with ART through Pat Conaty during the development stages of ART. Second, they invested in ART at its inception and kept in touch. Third, they were invited to join the ART board by Sir Adrian Cadbury (Chair of ART). Fourth, joining ART put the person on a steep learning curve to understand the market gap served by ART and operational procedures. Fifth, they then joined a number of ART's committees reflecting their expertise and experience (8e, UK, 19.01.06). Clearly, who you know and what you know is central to the board member selection process. It is essential that board members have expertise in a variety of areas so they can contribute to one or a number of the CDFI's committees: executive (strategy), remuneration (staff pay), lending (loan applications) and audit (decide on policies and how transactions are displayed in accounts) committees. Over time, the board membership changes creating shifting coalitions (Taylor, 1999) whereby assets, expertise and approaches are passed onto another group. For example, ART's first phase of development was a result of the founders of ART being able to plant ideas and let them grow but the second stage of development required recruiting more people with knowledge and experience of running a business. Therefore, there is a succession issue in the development of any organization whether, or not it is a social enterprise, e.g. visionary, operations, legal expertise. There may be an opportunity in the future when the visionaries are called upon to inspire new ideas into the organization and this means that in this sense the development process is both cyclical and progressive.

Charities are embedded in networks of other organizations and agencies (Butler and Wilson, 1990). Similarly, CDFI staff and board members are also embedded in local and non-local networks, for example one director reflected that his ‘involvement in the community brought [him] to the board’ (8d, UK, 13.01.06). These networks that are used to screen and recruit potential members to the board as one interviewee explained:

> ‘So really my knowledge of CDFIs and our link to the CDFA has …led me to develop the relationship with ART, and what I think we can bring to ART is a wider perspective of other CDFIs and the other issues that are facing some. I know Steve [Walker] has got close to them, but we get a feel through the links at the CDFA and the other CDFIs that we lend to. We are almost doing our own benchmarking of ART and how it performs, which is very useful. May last year, or was it June, having just finished another voluntary commitment, and I’d actually written to Steve and said look; if any of our investees need some of my time, Id be happy to do it and [he] said actually ART had had a few people moving on then …so why don’t you join ART?’ (8f, UK, 20.01.06).

As such, members join CDFI boards as part of their job, beliefs, personal agenda, and/or altruism which are key reasons for accessing committed individuals who are willing to actively participate in their role as a member of the board of directors. Also, members can develop a local reputation and to meet other business people.

ART's initial board of directors was created by its founders of ART (Sir Adrian Cadbury, Pat Conaty, Danyal Sattar). In 1997, the original board comprised those with key expertise:

Banking and Financial Expertise

- Ian Clegg (Regional Managing Director, Natwest Bank)
- Allister Marshall (Finance Manager, Studley High School)

Business and Operations Expertise

- Sir Adrian Cadbury (Chair and former Director, Bank of England, Chancellor of Aston University)
- David Brooks (Vice Chair and former Managing Director, Cadbury Schweppes)
- Clyde Pile (Managing Director, Glass processing and Chair, Birmingham Black Business Executive Forum)

Social Enterprise Expertise

- Martin Hockly (Manager, ICOF)
- Louise Kilbride (Housing Consultant)
- Chris Robertson (Chief Executive, Family Housing Association)
- Fleur Leach (Investment and Ethical Investment Expertise)

Management Consultancy Expertise

- Eoin McCarthy (Management Consultant)
- Bert Nicholson (Economic Management Consultant)

These board members were chosen to join the board through the friendship networks (and Quakers) surrounding the founders of ART as they provided a rounded skills and knowledge base for which ART could draw upon to build its foundations. Subsequently, Martin Hockly established another Birmingham based CDFI, Street UK, with substantial financial backing to set up a national micro credit institution in the UK. There are many more examples of staff or volunteers at ART who have used their skills and expertise to strengthen the sector, for example, William Derban who whilst undertaking his PhD on CDFIs, volunteered at ART and has since joined Barclays Financial Inclusion Team where he has established micro credit facilities in Ghana. This would suggest that ART has acted as a springboard for individuals and the development of other CDFIs. An alternative interpretation of sharing board members with other UK and West Midlands organizations is dynamic complexity, whereby people with key skills located in certain places are inextricably interlinked.

Since 1997, the board of ART has changed to reflect the needs of the business and to fill the gaps that have been left by members as they have resigned. In 2007, the board members were:

Banking and Financial Expertise

- Lowry Maclean (Chair and Chair of Wesleyan Assurance Society, past President of Birmingham Chamber of Commerce)
- Ian Clegg (Retired Regional Managing Director of Natwest Bank)
- Peter Kelly (Head of Financial Inclusion, Barclays Bank)
- Jeremy Wagg (Credit Policy Director, Futurebuilders)
- Duncan Murray (Banking Partner, Needham and James Solicitors)

Social Enterprise Expertise

- Laurice Ponting (Chief Executive, Mercian Housing Association)

Enterprise Expertise

- Professor John Bryson (Professor of Enterprise and Economic Geography, University of Birmingham)

Public Sector Regional Regeneration Expertise

- David Ritchie (Retired Head of Government Office for West Midlands)

Business and Operations Expertise

- Ray Lowe (Retired Senior Executive, Wesleyan Assurance Society)
- Honorary President, Sir Adrian Cadbury

However, this is only one version of the board and there are constant changes. With this information, the key board members of ART can be explored through their backgrounds, other relevant information and their influence on ART. Sir Adrian Cadbury was brought up under the Quaker philosophy which has evidently influenced his personal ambition to create ART, perhaps as a retirement project. He attended *Eton* and went on to read economics at *Cambridge University* where he joined the Olympic rowing team. He was selected as the Chair of UK Committee on Financial Aspects of Corporate Governance to produce the *Cadbury Report* in 1992. Sir Adrian is also a member of the *OECD* Business Sector Advisory Group on Corporate Governance. It proved vital to have someone as head of the organization with gravitas, business experience and certainly at launch, passion. Steve Walker was on secondment from Barclays when he joined ART as Chief Executive. His contacts at the bank led to the recruitment of two of ART's staff from Barclays. Without doubt, Sir Adrian Cadbury's contacts at the Bank of England had heard of ART's activity and he introduced the Chief Executive to the Governor. Subsequently, Steve Walker was asked to join a Government Taskforce. David Brooks was introduced to ART via Sir Adrian Cadbury as he was the Managing Director at *Cadbury Schweppes* and his operational/business experience could then be drawn at ART. Lowry Maclean also attended Eton and Cambridge and was part of the Cambridge rowing team and was a contemporary of Sir Adrian's brother. Lowry Maclean is Chairman of the Wesleyan Assurance Society, and he has a background in the corporate world, finance and the West Midlands. It was through Lowry Maclean that, in 2007, Ray Lowe was invited to be on the board of ART. Ray Lowe has experience of operations so was ideal candidate to bolster ART's operations. Networks have acted as the key driver, and proved vital, in accessing respected and good professional contacts in the board member recruitment process and to continue the status of ART as the UK's leading CDFI and the influence of their networks on the future of UK CDFIs.

When the Phoenix Fund was established in 2000, ART, because it was already established, was not a major beneficiary. This was because the *Department of Trade and Industry*[28] (DTI) wanted to test different business models. By the second round, it had become recognized that scale was vital to CDFI success and this could only be achieved by increasing capital support. ART had already achieved a degree of scale and only required capital (policy guarantee funds) to underwrite the risk in its portfolio and unlike many others in the sector did not require revenue support. By 2005, ART had expanded its loan activities and moved more closely to sustainability. However, along that route it was to experience major issues in connection with awareness raising, referrals and partnerships, particularly in the area of business support.

[28] The DTI is now known as the Department for Business, Enterprise and Regulatory Reform.

Organizational Strategy

Organizational strategy is viewed as the result of organized relations, between individuals and the firm. O'Neill and Gibson-Graham (1999:20) 'represent...enterprise as disorganized, incoherent and contradictory' in order to shift the predominant view that the firm is fixed into a fluid dynamic entity. Yet it is important for the organization to be consistent and focused on long term objectives. This is why ART is perhaps different to some other UK CDFIs:

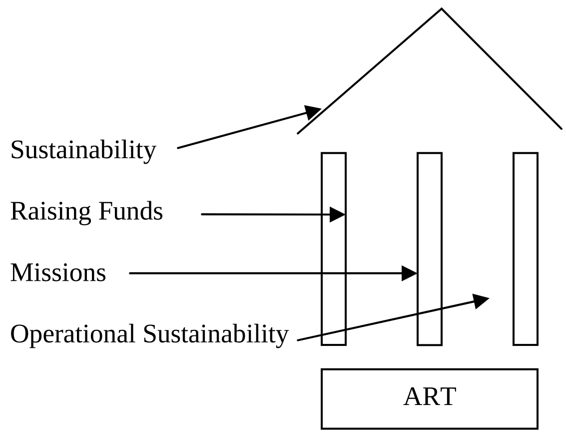
> 'right at the outset before a lot of other CDFIs got going, [we were] grounded in the principle of trying to move towards sustainability and the only way you could move towards sustainability was by lessening your requirement over time from the public sector' (8a, 13.01.06).

One member of the board suggested that when dealing with the core strategy:

> '[You need to think of an organization as a] temple with three pillars, with…ART [as a] foundation and one of those pillars is raising the money, and the next one is lending it for the right reasons and the third one is trying to get sustainability…reasonably profitably and build the roof and you've got a sound building' (8g, UK, 7.02.06).

This description is useful for conceptual purposes to identify ART's activity and strategy and to consider the larger picture, for example sustainability, whilst also considering the day-to-day operations of how this can be achieved and measured (Figure 7.3). The activities and strategy of ART is illustrated in the following diagram:

Figure 7.3: Organizational Strategy



(Source: 8g, UK, 7.02.06)

Organizations' boards of directors need to set strategy and to recruit committed staff. ART's Chief Executive was mentored by board members Bert Nicholson, Sir Adrian Cadbury and David Brooks to get the organization focused on realizing its mission. It is vital that the board of directors is highly committed, motivated and remains focused on the wider picture for its long term goals to be realized:

> 'engaging your non-executive directors and trying to give enough of their time is a real problem but it will raise the standards' (8g, UK, 7.02.06).

In taking account of these issues, systems can be created and implemented, uncertainty can be reduced, innovation can occur and risk minimized (Butler and Wilson, 1990), including, operational risk, credit risk, liquidity risk (Simpson and Evans, 2005).

Part of ART's organizational strategy is to encourage professionalism within the CDFI sector to ensure the sector has longevity:

> ‘Unless we can get some kind of professional approach into the CDFIs and Government and local authorities, it will continue in that British way of the gifted amateur, [but a] part time gifted amateur won’t work come the first crisis. I mean when the ocean is flat these businesses, even the very big ones go along nicely, but when it gets choppy you absolutely have to have professionals who understand that business you are in, in difficult conditions so I think that’s what [Sir] Adrian [Cadbury] was trying to do when he set up ART [which] was to set up a reasonably professionally run business, to get a good board [of] executive directors and move that into getting non-executive directors who don’t just turn up for board meetings but also try to engage with bits of the business, the older ones talk a lot like me but the younger ones are the ones who will actually build something that matters’ (8g, UK, 7.02.06).

Owing to ART being an IPS all board members have to be non-executive. However, executives (paid staff) are members of the board but are not directors. This adds another layer of complexity to the operations of ART. The board also needs to understand the complex nature of CDFI activity for CDFIs to work towards future sustainability:

> ‘I think they have got to have very clear debates at board level within the CDFIs about what their lending strategy and the medium to long term strategy is. I think many CDFIs are probably still maturing, there is the sort of honeymoon phase and I’m not sure whether they have got the right balance of directors on the board. I’m not sure if they have got a really long term plan and the issue of demand for their services is another one

> but there is nothing that I see at the moment that suggests to me that the majority of CDFIs will become sustainable in the short to medium term so hence I think it is really important they do look at their pricing and their risk and look to manage their bad debts because…as…over a number of years the CDFI is going to want to raise finance from a number of sources. Of course they are getting pump priming support from the Government, that support is uncertain as we go forward and other organizations such as the private sector such as banks and the foundations have again been supporting CDFIs, but how long they will continue to do so is open to debate and therefore the CDFI has to build as quickly as possible a good track record and the lower the level of defaults that they have the better the chance they are going to be able to borrow money against CITR in the future. If there defaults are going to be high then its really going to impinge upon their ability to raise finance so, therefore, that could impinge the future of the CDFI' (8h, UK, 05.06.06).

From this, it is clear that those who work at ART are highly committed individuals, with a shared value of helping enterprise access finance and producing a sustainable CDFI.

There is a danger in the implementation of benchmarking by the CDFA as CDFIs need skilled people to undertake the task and it is time and cost consuming. There needs to be standardization of methodology, results and guidelines, as for example there are three types of operational sustainability (Nicholson and NEF, 2003). Yet, it is important to recognize that:

> 'you can't always measure something. Getting measurement is very, very difficult sometimes, but by talking to people and listening and getting ideas…[but its about] quality up, costs down, nothing more complicated than that. …I think people working together to get a resolution of a problem is very important, that you don't exclude people and you make it inclusive' (8g, UK, 7.02.06).

Hence, defining the social and financial criteria is a highly complex process at the application stage:

> 'The social criteria…started primarily to help identify job creation opportunities and it spread out into social areas: is the company supplying a service which has the benefit of local community? Then environmental issues, does it impact on environmental issues? If it's a severe one obviously it's not what ART would probably be involved with. But predominantly the social filter would be between 1 and 5 its very much a guesstimate … we take a view on the business individual and where they score primarily the most focus on that,…if its creates job[s] and doesn't effect the environment, its probably got some social impact by creating wealth in the area then that's what we tend to support' (8c, UK, 13.01.06).

In this way, it can be inferred that ART adopts an inclusive approach to decision making and practices what it preaches. Compared to banks, CDFIs experience difficulty in measuring and assessing performance. Each loan fund has a different default rate and the different organizations sourcing those funds require accounts and reports at different time scales with different information and calculations. Also, CDFIs work in different markets and operate at different scales which presents a huge challenge to funders and the CDFA in trying to produce standard measures. A metaphor for CDFI operations is a game of chess, albeit several games of chess being played at the same time. Arguably, a simple way of reaching the financially excluded would be to administer grants. However, this would miss the point about creating businesses, jobs and commercial opportunities for the financially excluded and would not incorporate CDFIs missions.

CDFI board members are, in part, motivated by altruism. In 1948, Beveridge (121) stated that:

> 'The philanthropic motive - desire by one's own personal action to make life happier for others - has led to the development in Britain of an immense variety of institutions and societies'.

Without the services donated to CDFIs by their board members, it is unlikely that ART would have reached a certain level of maturity. The networks that the board members are embedded provide useful and essential linkages to funders and other sources of expertise. For CDFIs to be successful, it is essential for them to become embedded within both the public and private spheres of the locality so that they understand the local market. Strategic alliances are key to strengthening and creating a cohesive, recognizable sector. However, as Schoenberger (1997:47) suggests, 'strategic alliances must be based on trust and open communication…[but they] are by no means problem-free'. Therefore, the fuzzy concept of trust, which often does not exist between enterprises, must be replaced by risk minimization. Minimizing risk is vital within the local network (Lee, 1999), thus it is crucial for CDFIs to become embedded within the locality so that local knowledge and trust can be built.

ART's Clients

CDFI clients are the raison d'etre of CDFI activity. In order to access finance from ART, the applicant must have been rejected for a loan by a mainstream financial institution and be located within a disadvantaged area. The client must also fit the criteria of the CDFI that operates within that geographic area, for example some CDFIs only offer loans to women. Thus, CDFIs operate in a niche market and target specific groups of people. CDFIs, such as ART, must ensure that their market is large enough, targeting near bankable and viable business propositions, that business support is available and that their market is sufficient for them to operate in the long term. ART has shifted its markets from under £10,000 to larger loans. A constant flow of deals is required to keep a CDFI in operation to both secure funds and to use those funds appropriately and in a timely manner. However, there is a lack of awareness of the CDFI brand to attract clients:

> 'I suppose ART suffers in the same way that…[other companies] do…is awareness of the brand and…I believe there is probably a lot more demand out there that ART could do but people don't know that ART exists…I think it's big problem for ART particularly with the name actually ART was a dreadful name, what does ART mean? OK we want to get away from Aston so you call yourself ART but it really doesn't describe what you do but ART finance for business does describe a lot

> better what you do…There isn't an easy way to reach the small guy who may be thinking about setting up his own business. If there was an easy way it would be lovely but there isn't…So it's really linking into those small businessmen who are thinking of setting up and idea, that's a problem for ART and there is no simple solution' (8f, UK, 20.01.06).

This highlights the challenges in attracting clients to ART and the problems in having localized CDFIs, as they do not have the resources to market themselves in the same way as a commercial business and marketing does not necessarily produce the desired effect, for example, ART has advertised in local newspapers and on local radio which resulted in only a few deals. A representative from AWM concurs:

> 'It's not always the easiest sector to understand and…because it covers such a broad spectrum, you sometimes get mixed messages, or it's hard…to get clear messages or policies because they are trying to address too many things…I certainly think they could do with discarding probably the top end and…at the other end of the spectrum got those involved very much on personal and social activity rather than the ones more on enterprise and looking to be…independent sustainable businesses. So I think there needs to be…more segmentation…The other thing and I realize we are not in a good position to sort of say this, given our name, you know we chose to be called Advantage West Midlands rather than the West Midlands Regional Development Agency and the point I'm coming to is that the problem with the name CDFI's is that, people outside of CDFI's don't really know what they are, the name doesn't really give that

> much clue. The best bit is when it's got 'finance' or…'loan' in it people at least know what loans, most people know what loans are. It distinguishes that they are either being a grant. Institution sounds a bit strange as well and sometimes you get problems with community bit as well. So…one of the things now with…fair finance [consortium] and the website that they've developed is there's…issues around markets and the [need to] increase [the] of awareness of what CDFI's are and what they do' (15a, UK, 29.06.06).

Conversely, an ART member stated that:

> '[as ART] has been around for a while, so there is some awareness of ART amongst the banks so it is known and the fact that they do social enterprises as well as small businesses is good but that's a field still really to be exploited. There's a bit more coming through this year but it's well positioned in the sense that this Government really is committed to the development of social enterprises…so ART should be well positioned to pick up on the smallest of them' (8f, UK, 20.01.06).

When Sir Adrian Cadbury retired and he was replaced by Lowry Maclean, the decision was taken that finance for enterprise was the slogan. Subsequently, in the US, research indicated that the words community and development used by CDFI had negative associations. A new campaign has been launched by the US trade association, OFN, around the term 'opportunity finance'. This is an awareness issue concerning all CDFIs, not just ART:

> ‘I think they need to work an awful lot harder about raising awareness and I think the CDFA need to be able to help but one of the limiting factors, of course, is there isn’t a single brand, you know you have got these different CDFIs in the UK, they have all got different names haven’t they? So it doesn’t help at all. This is one of the advantages that the credit unions have, they have got one brand and even they have struggled so I’m not suggesting that’s the answer but its one part of the answer. But raising awareness in the local community is absolutely essential and, of course, all the different cultures in the communities as well so I think they have to work a lot harder than that and a lot harder on their relationships with solicitors, accountants and particularly the banks and as I say I think the way it has to be done is almost giving a business case to those organizations why they should support the CDFI rather than I think has happened in the past, the CDFI has sought of expected that people will support them, they’ve sort of expected that oh because we are socially motivated or because we are doing this good for society, people are bound to want to work with us, well life doesn’t work like that. Whatever you’re involved with you have to sell yourself and I think CDFIs have got to sell themselves a lot better in the local communities’ (8h, 05.06.06).

There needs to be a clear, simple way of describing UK CDFI activity to potential clients, source of referrals, and investors. As the sector is complex and diverse, it may be confusing and daunting for potential clients to approach CDFIs and for people to provide referrals to CDFIs.

The Clients View of ART

It was considered that it was also important to gain insight into how clients have responded to CDFIs, including ART, so that a rounded, holistic approach could be taken to discover the real value of the CDFI approach to providing finance for enterprise. A sample of eight of ARTs clients were selected to survey via telephone to participate in the research. Between 2005 and 2006, ART lent a record total of £1.2 million. From its inception until March 2007, ART had lent '£5.5 million to over 310 borrowers', preserving and/or creating over 2800 jobs for local people (ART, 2007b:1). This was at a time (summer 2006) when average borrowings were at the lower level (under £10,000). The clients, at the time, were all active in continuing to repay their loans. The data is not in any way representative of ART's operations. However, it demonstrates the variety of cases that ART deals with. The data collected from the survey is outlined in Table 7.1. Only one client was female, which perhaps demonstrates the low number of women seeking and/or accessing loan finance from ART. The clients were asked to describe their ethnic origin so that they were not automatically categorized. One client did not respond to this question, one client described themselves as British, one client was Black, one was of Pakistani origin, and four clients described themselves as white. The ethnicity data shows that a high proportion of the clients surveyed were of white origin, although this does not reflect the ART loan book. Six out of eight borrowers were running their first business and the half of businesses surveyed were less than three years old. Therefore it is not surprising that the majority of reasons for the loan was largely for working capital or to purchase equipment. In two of the cases, the loan was for start-up costs. The referral information highlighted the significance of word of mouth and networks in accessing finance, banks and business support services. Therefore, it is essential that CDFIs network in the locality and the local community. The loan amounts ranged from £5,000 to £20,000, the most common figure being £5,000 to £10,000. The sectors that the clients operated within were retail, social enterprise, consumer services (leisure facility) and other, which ranged from education and training to IT services. It appears that the number of jobs created and retained by the loan amount is not linked. Therefore, if there are a low number of jobs created and/or retained as a result of the loan, the business is or has the potential to provide a vital service for the community and/or local economy. As long as the business is viable and meets the criteria of being unbankable and fulfils the double bottom line, the business can access a loan from ART. The average perception of the clients experience of ART was 2, a positive score (the highest positive rating being 1 and lowest negative rating being 5). This suggests that ART is providing an essential service to the local economy and without sanctioning the loans to the enterprises surveyed, they may not exist.

Table 7.1: ART Client Survey

Gender	Ethnicity	First business	Sector	Turnover	Year business started	Referral	Loan purpose	Amount of loan	No of jobs Jobs created/ preserved	Perception of CDFI Scale (1= positive, 5= negative)
M	Black	Y	Retail	£300,000	1999	Friend	Working capital	5-10k	4.5	4
M		Y	SE	£1m	1998	Bank	Working capital cashflow		25	1
M	Pakistani	N	Other	£50k	2003	Contacts	Working capital	20k +	3	5
M	White	Y	Retail	Unknown	1994	Business Link	Working capital	10-15k	0	1
F	White	Y	Other	Unknown	2004	Bank	Working capital Equip't	5-10k	1.5	1
M	British	N	Other	£100k	2004	Business Link	Start-up	10-15k	1	1
M	White	Y	SE	£1.6m	1996	Friend	Equip't	5-10k	Unknown	1
M	White	Y	Retail	Unknown	2004	Bank	Start up	15-20k	5	2

Key
Equip't= Equipment

(Source: own research)

CDFIs need to engage with their clients post-loan to ensure that their businesses are receiving appropriate support, monitor the client to ensure that the loan will be repaid and perhaps to recognize whether the clients needs an additional loan in the future. Although, one ART board member commented that ‘ART operates well though there is a need to ‘interact’ with borrowers more’ (8e, UK, 19.01.06). This reflects the conflict between wanting to help the client and the client not wishing to receive additional support at that time and also the cost of providing business support.

ART Risk Profile

A quantitative analysis of the ART loan data was undertaken to identify the risks in the lending process. The quantitative analysis of the ART risk profile identified that the most significant category was the ‘lender’. This is due to the results illustrating that if one person, i.e. the loan officer or ‘recommender’ sanctioned a loan of less than £5,000 then there is 66% chance of the loan defaulting. If two people ‘sanctioned’ the loan (£10,000 to £20,000) i.e. loan officer and chief executive, then the risk of the loan defaulting is 61%. If the loan is £20,000 or above and is sanctioned by a few of the board of directors then there is 41% of the loan defaulting. The key issue here is that the risk of the loan defaulting between ‘recommender’ and ‘director’ is 25%. However, there are caveats to this analysis. The first is that the data are for 1997 to 2005. Since 2005, ART has recognized that the loans sanctioned under £10,000 had a greater risk of defaulting. As a result, ART has increased its loan size and they now offer £10,000 to £50,000. The increase in loan size suggests that ART is exposing itself to greater risk. Instead, by increasing the loan size available, ART has shifted away from start-up and smaller micro-enterprise loans, which are higher risk, and established itself in the existing enterprise and SME market. Without sufficient guarantee funds to sustain the risk levels of loans under £10,000 it became untenable to serve the start-up and smaller micro-enterprise market.

In this way, ART has developed its operational model as the market has shifted, reflecting the notion that businesses evolve over time and it has also been able to fulfil its mission by supporting local jobs for local people in existing businesses with a financing requirement that not able to be met by others.

Conclusions

The first part of the chapter explored the geographical debates relating to CDFI activity, namely charity, access to finance and uneven development. This reflected the complexity and difficulty in defining CDFI activity. The second part of the chapter showed how CDFIs fulfil a triple bottom line to highlight how difficult it is to balance their operations. The third part of the chapter explored a West Midland CDFI case study to demonstrate the complexity, dynamics, balancing and triple bottom line of ART. This was achieved by exploring how and why ART was established, the nature of its operations, its board of directors and its clients. This was to highlight the significance of CDFI board members in developing organizational strategy which essentially informs how the CDFI is managed and embedded in a range of networks, including access to potential borrowers and sources of clients. In sum, the ART case study illustrates the dynamic complexity surrounding CDFI operations.

The chapter has explored the dynamics surrounding West Midlands CDFIs in order to highlight the drivers of CDFI operations aside from funding and political support. The research has revealed that social relations, altruism, time, space are key to the success of CDFI operations. As CDFIs are social enterprises, they can fulfil philanthropic ambition, yet the research has shown that CDFIs still need to be viable businesses. Moreover, CDFIs need to fulfil their mission of providing access to finance for enterprise which means that they should concentrate on their enterprise markets and perhaps increase their geographical coverage so that all firms have equal opportunity.

This chapter has explored ART as a case study to highlight the complexity of UK CDFI operations within West Midlands CDFIs to show the issues that CDFIs face. The complexity of balancing CDFI operations is pervasive throughout the system. Balancing the social, economic and environmental objectives is inherent throughout the lending process and decision making, sources and uses of funding (and their restrictions), the staff, board of directors and their networks. As such, the triple bottom line infiltrates and influences each part of the CDFI. The complexity is, therefore, inherent within each individual, the CDFI system, and each loan decision. In comparison to mainstream banks which have a neat standardized system, CDFIs can be characterized as dynamic complexity.

CHAPTER 8 OVERCOMING FINANCIAL EXCLUSION? US AND UK CDFIS

This thesis has explored the geographies, operations, effectiveness and potential impacts of US and UK CDFIs. The analysis began by exploring the existence of a number of financial gaps that prevent firms from obtaining loans to finance the establishment of new business ventures or to invest in existing enterprises. The persistence of the start-up finance gap indicates that mainstream financial institutions are disinclined to lend to enterprises, whether for-profit or not-for-profit, that do not have the right business track record, or lack appropriate collateral. CDFIs aim to help bridge the funding gap that affect these enterprises. CDFIs are place-based institutions that engage in strategic interventions in local economies using local knowledge to counter disadvantage, lessen the impact of start-up finance gaps and create business opportunities. This thesis has explored US and UK CDFI lending processes to determine how the triple bottom line is balanced and the ways in which CDFIs become embedded within local financial and business support networks. The research included extensive semi-structured interviews with key actors in the US and UK CDFI sectors, CDFI borrowers and a detailed case study of ART's loan portfolio to explore how CDFIs operate and balance their social and financial objectives. The key contributions of this thesis are first, its exploration of access to finance for enterprises which are financially excluded from mainstream financial institutions, second through an analysis of CDFIs as a source of finance for enterprise and third, a comparative study of US and UK CDFIs. This chapter will, first, consider; the alternative nature of CDFIs, the different types of CDFIs, the dynamic complexity of CDFI operations, triple bottom line and the uneven access to enterprise finance and, second, identifies where future research might focus.

US and UK CDFI Operations

This thesis began by exploring if US and UK CDFIs could be considered as alternative financial vehicles, compared to the mainstream banks, as they help individuals and firms that have been financially excluded. CDFIs serve financially excluded enterprises by providing access to credit and, in so doing, overcome financial exclusion in which individuals are denied access to various forms of financial products and services. In working to a triple bottom line, CDFIs are independent financial institutions that provide capital and support to empower individuals or organizations at the commercial margins to develop opportunity and wealth in disadvantaged areas. These institutions are involved in relatively high risk lending and consequently have high default rates. In simple terms, two types of CDFI can be identified (with three different operating styles). First, those that set their own strategies and agendas and, second, those that have been established in response to public policy. CDFIs only provide a partial solution to the finance gap as there is an uneven geography of CDFI provision. Many CDFIs have been established by local volunteers rather than being the product of an organized movement or public policy intended to ensure equal access to CDFI services throughout the US and UK. At the moment, an unequal geography of CDFI provision implies that CDFI will only contribute to overcoming financial exclusion in some parts of the US and UK.

Uneven Access to Finance

The issue of uneven access to finance amongst US and UK CDFIs was explored throughout this thesis. CDFIs have not yet developed at the scale that is required to overcome financial exclusion. Lending to those that are financially viable but excluded from mainstream finance is difficult and also is associated with relatively high financial risks for the CDFI. UK CDFIs offer finance at rates that are higher than mainstream financial institutions as they are taking on additional risk by acting as lenders of last resort, operate in disadvantaged communities and rarely have access to collateral to guarantee their loans. As many CDFIs operate revolving loan funds, they rely on loans being repaid on time and in full. CDFIs will never become sustainable as they require grant funding to underwrite the risk of lending to the financially excluded and to cover the cost of defaulting loans. Some CDFIs try to balance their lending by operating in different markets, for example, social enterprise loans are low risk which can offset the risk of lending to micro-enterprises. The demand for social enterprise loans is low which makes it difficult to balance a CDFIs loan portfolio. If a CDFIs manages its default rate, take lower risks and becomes nearly sustainable then the danger is that it may begin to operate in a near to mainstream manner and this would mean that a greater finance gap would continue to exist in their area of operation. It is important to note that like poverty finance gaps are a relative concept. A financial gap will always exist as some business proposition will never be viable financial propositions.

US and UK CDFIs may never achieve the scale to have a significant impact on financially excluded enterprises. Each CDFI has a different business model, operational structure, funding streams, markets, products, services, and scale which is leaving geographical gaps in the types of finance available. A CDFI may be embedded in the locality and responsive to local needs but the demand may not be met as the area has multiple needs, for example business and personal finance. Neither will they achieve scale without consistent and relatively constant policy support. A significant proportion of US and UK CDFIs remain dependent upon Government support as many CDFIs have not reached sufficient scale and maturity to be independent of external funding. Some US and UK CDFIs supplement their lending through their existing enterprise support services. Some CDFIs have been able to source other funding streams from not-for-profit foundations, banks (through market value loans), and private investors. Attracting funding is problematic due to a lack of transparency and benchmarking within the sector. This research has established an understanding of the geographies created by CDFIs. Coverage is dependent upon groups of individuals coming together to establish a CDFI with the right expertise and experience. This process means that CDFIs are locally embedded institutions that are designed to address local needs through the articulation of different operational models.

Alternative Geographies of Finance?

US and UK CDFIs are creating alternative geographies of finance due to the application of their social missions. However, their missions have evolved over time so there is a constant conflict between mission and sustainability. Also, some US and UK CDFIs have been established by pioneering social entrepreneurs. Yet, as the social entrepreneurs may not have all the skills required to run this type of business, people from banking backgrounds have been recruited thereby beginning a process by which CDFI activity is becoming institutionalized and formalized. US and UK CDFI lending activity relies on old fashioned banking practices which ignores credit scoring and assesses the viability of each application individually through a review of the character and ability of the client to repay the loan. The quality of the relationships banking that exists between a CDFI and its borrowers must be questioned as the quality of the relationship may decay during the course of the loan – from strong during the loan application process to weak during times when the borrower may default. Thus, the type of CDFI relationship banking is time and space specific. US CDFIs are not lenders of last resort and strategically target 'emerging markets' rather than deprived markets where, in some cases, they are competing with banks for business but UK CDFIs are lenders of last resort. US CDFIs have taken the place of local banks which have shifted their operations towards national and international markets. As a result, it can be suggested that US and UK CDFIs complement neoliberal capitalism and are not oppositional to the mainstream banks as they rely on the state and complement mainstream financial institutions (Amin *et al*. 2002) and act as a stepping stone to make borrowers bankable in the long term.

The Different Types of CDFIs

This research identified that three different types of CDFI operate in the US and UK: policy driven CDFIs (of which project based CDFIs are a subset), diverse CDFIs and balanced CDFIs. Policy driven CDFIs are those that were established, or shifted their operations, in response to policy and access to public funding. However, Government provided funding does not necessarily match client needs. Among policy driven CDFIs there is a subset of CDFIs identified as project based CDFIs which operate a number of funds on a short term basis to deliver grant funded policy initiatives. Diverse CDFIs have diversified their products and markets and in the process, have become increasingly commercial. However, these CDFIs have adopted an entrepreneurial operational strategy and have become increasingly risk averse in an attempt to make their activities sustainable. Diverse CDFI activity suggests that they aim to be independent of public funds and the limits surrounding the use of public funds. Balanced CDFIs are a small subset of policy driven and project based CDFIs that have more diversified funding streams and try to manage to balance their financial and social missions. As a result, these CDFIs may be successfully reaching financially excluded enterprises. By balancing their portfolio, these CDFIs may attract additional funding from foundation and not-for-profit investment. By adapting the balanced operating style, CDFIs may become respected by those within and out of the sector and be viewed as models of best practice. It may be suggested that the diversity of US and UK CDFIs is a result of access to certain funding streams (government, not-for-profit, individuals, private sector business) and the use of these funds influences their strategies, operations and missions.

Dynamic Complexity of US and UK CDFIs

US and UK CDFIs can be linked through the concepts of complexity and dynamism. CDFIs are highly complex organizations. CDFI operations are constrained by the geography and flow of funds into and out of the organization. Within the lending process temporary complexity exists as the lending committee balances the risks and rewards of each loan alongside the CDFIs strategy. CDFIs have not yet established generic criteria to measure and monitor their activities. As CDFIs grow and become established organizations they will need to measure their impacts and sustainability. The difficulties in producing accountable organizations reflects the fact that CDFIs cannot easily be benchmarked against each other – each CDFI in the UK tends to be distinctive and the 'sector' is best described as heterogeneous. Given this CDFI performance cannot be measured and compared and perhaps this implies that the trade associations (OFN and CDFA) are redundant organizations. Innovation within the sector might be undermined if all CDFI adopted a common business model and it is important to remember that CDFIs have developed to meet the requirements of local needs.

Triple Bottom Line

The dynamic complexity of CDFIs can also be demonstrated through their triple bottom line (Figure 7.2). The triple bottom line incorporates three related dimensions: social, financial and environmental objectives. Within each objective lies a set of values. It is these values which influence and provide another level of the complexity that exists within CDFI operations, particularly within the loan decision process. First, the financial objectives are to create financial inclusion through employment and access to finance. Second, the social objectives of CDFIs promote social inclusion by creating or retaining local jobs. Third, the environmental objectives are typified by lending to a specific geographical area, and businesses that promote environmentally friendly practices. These objectives are all intricately linked which makes it hard to separate them into discrete issues. CDFI operations, the loan application process and performance measurement remains a challenge for each CDFI. The interrelated nature of these criteria is the reason why the boundaries of these concepts are blurred and that CDFIs are diverse and complex organizations. As the balance between the financial, social, environmental objectives has to be sustained and the flows into, within and out of each CDFI constantly change, it could be stated that CDFIs are dynamic and flexible organizations which respond to and instigate change depending on their strategy and operating style. In this way, it may be argued that some US and UK CDFIs are experiencing controlled, sustainable failure as long-term sustainability can never be maintained without a constant injection of external capital to cover loans that have defaulted.

There is an assumption by the US and UK Government that a finance gap exists within the start-up market. It is important to remember that CDFIs are an effective means of creating and protecting local employment. The cost of subsidizing a CDFI's operations is perhaps much lower than the costs related to long term welfare payments. The ART borrower's survey suggests that CDFIs are providing an essential service to the local community or economy and that they play an important role in maintaining and creating local employment.

Further Research

This research has explored US and UK CDFIs as one part of the solution to tackle financially excluded enterprises located in a particular time and space. The research has focused on access to finance for enterprise using US and UK CDFIs as an example of financing marginalized communities to reduce inequality within the financial system and society. CDFIs are, therefore, only part of the story as they operate revolving loan funds, and are a particular type of CDFI. Further research should explore the wider role CDFIs play in local economies by undertaking research into community development banks, community development credit unions, community development loan funds, and community development venture capital funds including personal and enterprise finance. Moreover, as UK CDFIs are currently at a critical juncture in their development there remains scope for future research as the CDFI sector matures and develops over the coming years. Another strand of research that urgently needs to be undertaken is detailed research into CDFI clients and especially the longer term social, economic and political impacts that can be related to CDFI lending activities.

APPENDICES

Appendix 3.1: UK CDFIs

Abi Associates

ACETS

Arrow Fund

Aspire: Micro Loans for Business

Aston Reinvestment Trust (ART)

BigInvest

Black Business in Birmingham

Black Country Reinvestment Society

Blackpool Moneyline

Bolton Business Ventures Ltd (BBV)

Bradford Chamber of Commerce and Industry

Bridges Community Ventures

Bristol Enterprise Development Fund

Business in Prisons

Business Link Berkshire/Wiltshire Fund2Grow

Capitalise Business Support Ltd (CBS)

CEED

Change: Community Finance

Charity Bank

Coventry and Warwickshire Reinvestment Trust

Culture Finance North West

Cumbria Asset Reinvestment Trust (CART)

Derby Loans

Developing Strathclyde

DIP

East End Reinvestment Trust - EERT (See Fair Finance)

East Lancashire Moneyline (ELM)

East London Small Business Centre

Enterprise Loan Fund

Environment Trust (See Fair Finance)

Ethnic Business Development Corporation (Ethnic Mutual)

Fair Finance (part of East End Reinvestment Trust)

First Enterprise Business Agency

Five Lamps

Frederick’s Foundation

Future Builders

Gloucestershire Development Loan Fund

Goole Development Trust

Granby Toxteth Development Trust

HBV Enterprise

Head for Business

IMPACT-Communities in Partnership for Action / Moneyline Yorkshire

Impetus MARCHES

Incredit

Industrial Common Ownership Finance (ICOF)

Into Business Scheme

Key Fund South Yorkshire

Lincolnshire Development

Local Investment Fund (LIF)

London Rebuilding Society (LRS)

MANSKEP

Merseyside Special Investment fund (MSIF)

Moneyline Yorkshire (IPS) Ltd

Nazir Assciates/West Midlands Inclusive Fund (Halal Fund)

New Horizons Saving and Loan Scheme (NHSLS)

Norfolk and Waveney Enterprise Services (NWES)

North Derbyshire Chamber of Commerce and Industry

North East Social Enterprise Partnership

North London Chamber and Enterprise Credit Union

North Staffs Risk Capital Fund

Northern Oak Credit Union

Onelondon

Partnership Investment Fund

Preston Moneyline

Project North East (PNE)

Prya Partnerships

Salford Moneyline (SML)

Sandwell Advice and Moneylink (SAM)

Social Investment Scotland (SIS)

South Coast Moneyline (aka PART)

South East Northumberland Enterprise Trust (SENET)

South West Investment Group (SWIG)

South Yorkshire Investment Fund

Street North East

Street UK

Suffolk Regeneration Trust (SRT)

Sussex Enterprise

The Enterprise Fund

The Prime Initiative

The Prince’s Trust

Train 2000

Triodos Bank

Ulster Community Investment Trust

Urban Partnership Group

Wessex Reinvestment Trust

West Yorkshire Enterprise Agency/MYCCI

Women’s Education in Building

Women’s Employment Enterprise and Training Unit (WEETU)

(Source: Own research)

Appendix 3.2: Email to Potential US and UK CDFI Case Studies

Re: Overcoming Financial Exclusion: CDFIs and the balancing of financial and social objectives

I am a Doctoral researcher in the Department of Geography at the University of Birmingham, UK sponsored by the Economic and Social Research Council (ESRC) and working with the Aston Reinvestment Trust (ART). My research focuses on CDFIs that provide finance for business enterprises in the UK and USA. This is to discover how CDFIs balance their socio-financial objectives whilst developing their business activity. The research aims to;

1. understand how CDFIs provide access to finance and how they bridge the gap between fulfilling social objectives and economic purposes.

2. define how CDFIs in the UK and USA identify and measure effectiveness of socio-economic criteria that drive the business.

3. compare CDFIs with other UK and USA CDFIs through benchmarking.

4. consider the processes in which CDFIs become embedded in local financial and business support networks.

5. this is to essentially, identify best practice to develop and inform other UK CDFIs in the future.

I would like to arrange to spend a day at your office to gain an understanding of the organization and how it operates, and to undertake a series of interviews with yourself (on your role, also how and why your organization has developed in the way it has), 2 loan officers (on the application process), 2 or 3 members of the board (on their role and experience) and 4 small business clients (on the application process and how a loan from your organization has made their business succeed).

In return for assisting my research, I will send you a summary of my findings towards the end of my project.

I am available to visit your organization at your convenience.

If you have any queries, please do not hesitate to contact me.

Kind regards,

Lindsey Appleyard

Doctoral Researcher
School of Geography, Earth and Environmental Sciences
The University of Birmingham, UK

(Source: Own Research)

Appendix 3.3: Interview Questions for US and UK CDFI Case Studies

Introductory questions

- What is your background/role?

How and why was the CDFI established?

- Who founded the organization?
- When was the CDFI founded?(Month/Year)
- What is the role/mission of the CDFI?
- When did the organization start financing?
- How has the organization developed?
- Why has it done so in this way?
- Which (geographical) areas do you serve?
- Disagreements/conflict resolution?

How is it run? (Resources- finance, labour, etc)

- How many staff? What are their roles?
- No of loans approved?
- Size of funding?
- Bad debt rate?
- Interest rate?
- Sectors?
- Size of Loans?
- Purpose of loan?
- Any other services?
- Disagreements/conflict resolution?

How was it financed?

- What methods do you use to raise capital?

Networks

- What proportion of your organizations time is spent:
  - delivering services
  - securing funding

- What is your relationship with: other CDFIs; other institutions?
- Do you co-ordinate with other organizations locally/regionally/nationally/internationally?
- How do CDFIs become embedded within the system/network/locality?

Referrals/Applications (Declines/Accepted)

- Lending Criteria
- Lending process
- What do your clients think they are assessed on?
- Referrals? From who? Under what circumstances? How efficient is this for deal flow?
- Monitoring process?
- Post-loan support?
- Details of Client case studies
- How do they reach their target market?
- How do they define bad debt/write off rates?
- Cost per loan?
- Disagreements/conflict resolution?

Performance

- How do you measure your CDFIs performance?
- How do you define social and economic criteria?
- Do you use benchmarking?
- Define sustainability

Finally

- What factors facilitate your work?
- What factors hinder your work?
- How do you see the market changing in the future?
- How will your CDFI respond?

(Source: Own research)

Appendix 3.4: Client Questionnaire

- Age of business owner
- Gender
- Ethnicity
- Any previous experience in market
- First or only business
- No of owners
- Legal status of business
- What does business do
- What is distinctive about its products/services
- Reason for seeking finance
- Why ART
- Other funding
- Other organizations approached prior to ART
- Differences in obtaining finance
- Impact on access to finance
- Additional impact
- Location
- Sector
- Turnover
- No of employees
- Loan Category
- Year Business Started
- Referral
- Time since loan
- Loan purpose
- Amount of loan
- Loan term
- Application process
- What was good
- What could be better
- Interest rates
- Post loan support
- Repayment problems
- Future loans
- What contribution does your company make to the local economy?
- No of jobs created/preserved
- Jobs created by category
- Perception of CDFI scale
- Any comments

(Source: Own research)

Appendix 5.1: Case Study 2

Case Study two was established in 1985 with the purpose of creating wealth and opportunity in deprived areas to people and places through socially responsible investment (2a). This CDFI serves a sub-regional geographical area in both urban and rural locations. The total value of loans delivered (at the end of the 2004/5 financial year) was in excess of $440 million through 1500 transactions. In 2004/5, case study two had invested $82.5 million in loans to the local community. The CDFI offers finance to a number of sectors including affordable housing, community projects, private equity (which is supported in part by the NMTC), small business and sustainable energy (for renewable and/or energy efficiency projects) in 'emerging markets' (2h). The variety and scale at which this organization operates is indicative of the challenge that CDFIs face when defining their activities. Moreover this case study highlights the difficulty in defining CDFI activity as they are so diverse and dynamic and shift according to the market and funding requirements. The small business lending team was established in 1998 and has since financed over 200 small businesses. This figure is low within the total number of transactions and small business activity accounts for just 14% of the cumulative total organizations lending operations. This low figure can be accounted for in the small business default rate which is between 10-15%. As such, providing finance to small business is high risk in comparison to community based lending and the more secure, low risk, high figure loans for affordable housing and community projects offsets the risk when lending to small business. The small business operations mitigate risk by providing other services to clients such as technical assistance and always take collateral in the form of personal guarantee, security and/or SBA Guarantee. In addition, the small business team would even like to devise a credit scoring model for CDFIs. Due to the risk aversion of this case study, they have been able to become 91% sustainable. By taking a risk averse approach, does this mean that CDFIs are transforming themselves into mini-banks?

Appendix 5.2: Balance Sheet of Case Study 2

Financial Position Data	**2005**	**($ in thousands)**
Total assets	114,008	
Loans and leases receivable	61,672	
Allowance for loan and lease losses	3,083	
Investments	28,350	
Programme Investments	802	
Investments in limited partnerships	4,853	
Loans payable	58,617	
Net assets		
Unrestricted	21,818	
Temporary restricted	14,707	
Permanently restricted	6,944	
	43,469	
Total net assets	43,469	
Activities Data		
Net interest income	3,368	
Provision for loan and lease losses	390	
Investment advisory fees	1,501	
Grants and contributions	8,828	
Programme services and fees	3,103	
Change in net assets	11145	
Other Data		
Assets under management	255,380	
Allowance for loan and lease losses as a % of total loans and leases	5%	
Net loan loss (recovery) ratio	0.25	
Self-sufficiency ratio	91%	
Total Financing	82.5 m	
Commercial Real Estate	36.8m	(34.3m of that is NMTC)
Loan loss provision	390k	
Net charge off	155k	
Policy, Workforce and Neighbourhood Development Programmes	2m	
Consolidated assets	114m	
Capital under management	255.4m	

(Source: Case Study 2 Annual Report, 2005)

REFERENCES

ABCUL (2002) 'A brief history of the credit union movement' [online]. Manchester, Association of British credit unions. Available at: www.abcul.org/lib/liDOWNLOAD/17/ABCUL%20History%20Of%20Credit%20Unions.pdf (Accessed 27.06.05).

Acs, Z. and Varga, A. (2005) 'Entrepreneurship, agglomeration and technological change'. Small business economics, 24 (3) 323-334.

Acs, Z. J. and Storey, D. J. (2004) 'Introduction: entrepreneurship and economic development'. Regional Studies, 38 (8) 871-877.

Ainger, B. Brocklehurst, R. and Forster, S. (2002) 'Feasibility Study into a wholesale intermediary for community development finance'[online]. London, New Economics Foundation. Available at: http://www.neweconomics.org/gen/z_sys_PublicationDetail.aspx?pid=134 (Accessed 10.10.04).

Amin, A. Cameron, A. and Hudson, R. (1999) 'Welfare as work? The potential of the UK social economy'. Environment and planning a, 31, 2033-2051.

Amin, A. Cameron, A. and Hudson, R. (2003) 'The alterity of the social economy'. In Leyshon, A. Lee, R. and Williams, C. C. (Eds) Alternative economic spaces. London, SAGE.

ART (2006) 'Newsletter April 2006'. Birmingham, ART.

ART (2007a) 'Our investors' [online]. Birmingham, ART. Available at: http://www.reinvest.co.uk/art/investors (Accessed 26.03.07).

ART (2007b) Annual report. Birmingham, ART.

Avery, R. B. Bostic, R. W. Calem, P. S. and Canner, G. B. (1997) 'Changes in the distribution of banking offices' [online]. Federal reserve bulletin, September, 707-725. Washington, Federal reserve. Available at: http://federalreserve.gov (Accessed 17.06.05).

AWM (2004) 'OECD local entrepreneurship reviews: West Midlands, United Kingdom'[online]. Birmingham, Advantage West Midlands. Available at: http://www.advantagewm.co.uk/downloads/oecd-final-full-report-aug-2004.pdf (Accessed 16.08.05).

AWM (2005) 'Presentation to the regional finance forum from community development finance West Midlands 29.04.05'. Birmingham, Advantage West Midlands. Unpublished.
Barclays (1987) Guide to good lending practices. London, Barclays Bank PLC, Central advances department.

Barr, M. S. (2005) ‘Credit where it counts: the community reinvestment act and its critics’. New York university review, 80 (2) 513-652.

Baue, B. (02.06.2006) ‘The numbers and the stories behind them on community development financial institutions’ [online]. Socially responsible investment. Available at: http://www.sri-adviser.com/news/article.cgi/article2022.htm (Accessed 08.09.07).

Baxter, J. and Eyles, J. (1997) ‘Evaluating qualitative research in social geography: establishing ‘rigour’ in interview analysis’. Transactions of the IBG, 22 (4) 505-525.

Bell, E. and Read, C. (1998) ‘On the CASE: advice for collaborative studentships’ [online]. Swindon, ESRC. Available at: http://www.esrctoday.ac.uk/esrcinforcentre/images/onthecase_tcm6-7296.doc (Accessed 01.07.07).

Benjamin, L. Rubin, J. and Zielenbach, S. (2004) ‘Community development financial institutions: current issues and future prospects’. Journal of urban affairs, 26 (2) 177-195.

Bennett, K. (2002) ‘Interviews and focus groups’. In Shurmer-Smith, P. (Ed) Doing cultural geography. London, SAGE.

Berger, A. N. and Udell, G. F. (1998) ‘The economics of small business finance: the roles of private equity and debt markets in the financial growth cycle’. Journal of banking and finance, 22, 613-673.

Beveridge, W. (1944) Full employment in a free society. London, Allen and Unwin.

Beveridge, W. (1948) Voluntary action: a report on methods of social advance. London, Allen and Unwin.

Bitler, M, P. Robb, A. M. Wolken, J. D. (2001) ‘Financial services used by small businesses: evidence from the 1998 survey of small business finances’ [online]. Federal reserve bulletin, April, p183-205. Washington, Federal reserve. Available at: http://federalreserve.gov (Accessed 17.06.05).

BOE (2000) ‘Finance for small businesses in deprived communities’ [online]. London, Bank of England. Available at: http://www.bankofengland.co.uk (Accessed 11.11.04).

BOE (2002) ‘Finance for small firms, a ninth report’ [online]. London, Bank of England. Available at: http://www.bankofengland.co.uk (Accessed 04.10.04).

BOE (2003) ‘The financing of social enterprises: a special report by the bank of England’ [online]. London, Bank of England. Available at: http://www.bankofengland.co.uk (Accessed 04.10.04).

BOE (2004) 'Finance for small firms: an eleventh report' [online]. London, bank of England. Available at: http://www.bankofengland.co.uk (Accessed 04.10.04).

Bolton and Committee (1971) Report of the committee of inquiry on small firms. London, HMSO.

Braunstein, S. and Welch, C. (2002) 'Financial literacy: an overview of practice, research and policy' [online]. Federal reserve bulletin, November, 445-457. Washington, Federal reserve. Available at: http://www.federalreserve.gov (Accessed 17.06.05).

Bridges, J. (2006) 'Maximizing the CASE impact: sharing experience of lessons learned for enabling effective and productive PhD CASE studentship working-relationships'. Available at: http://www.geography.dur.ac.uk (Accessed 20.02.06).

Brown, M., Conaty, P. and Mayo, E. (2003) Life saving community development credit unions. London. NEF/National association of credit union workers/National consumer council.

Bryson, J. R. Daniels, P. Warf, B (2004) Service worlds: people, organizations, technologies. London, Routledge.

Bryson, J. and Taylor, M. (2006) 'The functioning economic geography of the West Midlands' [online]. Birmingham, The university of Birmingham. Available at: http://www.gees.bham.ac.uk/people/brysonresearch/Functioning-Economic-Geography_V1.0_Report_SM%20Final%20Copy%20Aug%2011%202006.pdf (Accessed 12.12.06).

Bryson, J. and Buttle, M. (2005) 'Enabling inclusion through alternative discursive formations: the regional development of community development loan funds (CDLFs) in the United Kingdom'. Service industries journal, 25 (2) 273-288.

Bryson, J., McGuinness, M. and Ford, R. G. (2002) 'Chasing a 'loose and baggy monster': almshouses and the geography of charity'. Area, 34 (1) 48-58.

Burns, D., Williams, C. C. and Windebank, J. (2004) Community self-help. London, Palgrave.

Butler, R, J. and Wilson, D, C. (1990) Managing voluntary and non-profit organizations: strategy and structure. London, Routledge.

Buttle, M. (2005) 'Tracing ethical finance in the social economy: a multi-locale ethnography'. The university of Birmingham, unpublished PhD thesis.

CDFA (2004b) 'Strategic plan' [online]. London, Community development finance association. Available at: http://www.cdfa.org.uk (Accessed 01.05.04).

CDFA (2004c) ‘Inside out: the state of community development finance 2003’. London, Community development finance association.

CDFA (2005)‘Inside out: the state of community development finance 2004’. London, Community development finance association.

CDFA (2007) ‘Performance and benchmarking’. Community development finance association annual conference, 21st June 2007.

CDFI Fund (2005a) ‘Overview’ [online]. Washington, US department of the treasury. Available at: www.cdfifund.gov/overview/index.asp (Accessed 20.06.05).

CDFI Fund (2005b) ‘CDFI fund bank enterprise award program 2005 Application’ [online]. Washington, US department of the treasury. Available at: http://www.cdfifund.gov/docs/BEA/2005/2005BEAapplication.pdf (Accessed 28.10.05).

Clark, G.L. (2005) ‘Money flows like mercury: the geography of global finance’. Geografiska annaler B, 87, 99-112.

Cole, R. A., Goldberg, L. G. and White, L. J. (2004) ‘Cookie cutter vs. character: the micro structure of small business lending by large and small banks’. Journal of financial and quantitative analysis, 39 (2) 227-251.

Collin, S. Sattar, D. Fisher, T. Mayo, E. and Mullineux, A. (2001) A proposed performance and accountability framework for community development finance in the UK. London. NEF.

Connon, H. (02.04.06) ‘Brown’s social banking fails to catch on’ [online]. London, The Observer, Business. Available at: http://observer.guardian.co.uk/business/story/0,,1744634,00.html (Accessed 05.04.06).

Cook, B. (25.05.05) ‘CDFIs ‘can’t lend on a large scale’’. Third sector, 19 (120) 15.

Cressy, R. (2002) ‘Funding gaps: a symposium’. The economic journal, 112 (February) F1-F16.

De Meza, D. (2002) ‘Overlending?’ The economic journal, 112 (February) F17-F31.

Deloitte and Touche (2002) Access to finance: opportunities and constraints for business development and growth in the West Midlands. Birmingham. Deloitte and Touche for Advantage West Midlands.

DCLG (2006) ‘The economies of deprived neighbourhoods’ [online]. London, Department for communities and local government. Available at: http://www.communities.gov.uk/pub/193/TheEconomiesofDeprivedNeighbourhoodsSummaryofResearch_id1501193.pdf. (Accessed 16.10.06).

DeYoung, R. Klier, T. and McMillen, D. P. (2004) 'The changing geography of the U.S. banking industry'. The industrial geographer, 2 (1) 29-48.

DTI (2003) 'Small firms loan guarantee' [online]. London, Department of trade and industry. Available at: http://www.sbs.gov.uk (Accessed 10.10.04).

Dyer, L. S. (1977) A practical approach to bank lending. London, The institute of bankers.

Dymski, G. A. and Veitch, J. M. (1996) 'Financial transformation and the metropolis: booms, busts, and banking in Los Angeles'. Environment and planning a, 28, 1233-1260.

EC (2007) 'SME definition' [online]. Brussels, European commission. Available at: http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/index_en.htm (Accessed 29.07.07).

Emerson, J. (2003) 'The Blended Value Proposition: Integrating Social and Financial Returns'. California management review, 45 (4) 35-51.

ESRC (2006) 'Research ethics framework' [online]. Swindon, Economic and social research council. Available at: http://www.esrctoday.ac.uk/ESRCInfoCentre/Images/ESRC_Re_Ethics_Frame_tcmb_11291.pdf (Accessed 05.07.07).

ESRC (2007a) 'Benefits of CASE studentships' [online]. Swindon, Economic and social research council. Available at: http://www.esrcsocietytoday.ac.uk/ESRCInfoCentre/Opportunities/postgraduate/pgtrainingpolicy (Accessed 05.07.07).

ESRC (2007b) 'The benefits of collaborative research between academic and public/voluntary sector partners' [online]. Swindon, Economic and social research council. Available at: http://www.esrcsocietytoday.ac.uk/ESRCInfoCentre/opportunities/postgraduate/pgtrainingpolicy/index3.aspx?ComponentId=4681andSourcePageId=5405 (Accessed 01.09.07).

Ettlinger, N. (2003) 'Cultural economic geography and a relational and microspace approach to trusts, rationalities, networks, and change in collaborative workplaces'. Journal of economic geography, 3 (2) 145-171.

Evans, D. E. and Jovanovic, B. (1989) 'An estimated model of entrepreneurial choice under Liquidity Constraints'. The journal of political economy, 97 (4) 808-827.

FSA (2004) 'What is a credit union?' [online]. London, Financial services authority. Available at: http://www.fsa.gov.uk/credit_union/cu_what.html (Accessed 01.12.04).

Fraser, S. (2004) 'Finance for small and medium-sized enterprises: A report on the 2004 survey of SME finances' [online]. Warwick, University of Warwick. Available at: http://www.wbs.ac.uk/downloads/research/wbs-sme-main.pdf (Accessed 11.05.06).

Fuller, D. and Jonas, A. E. G. (2002) 'Institutionalizing future geographies of financial inclusion: national legitimacy versus local autonomy in the British credit union movement'. Antipode, 34, 85-110.

Fuller, D. and Jonas, A. E. G. (2003) 'Alternative economic spaces' in Leyshon, A., Leyshon, A. Lee, R. and Williams, C. C. (Eds) (2003) Alternative economic spaces. London, SAGE. 55-73.

George, J. M. and Jones, G. R. (2000) 'The role of time in theory and theory building'. Journal of management studies, 26 (4) 657-684.

Gertler, M. (1988) 'Financial structure and aggregate economic activity: an overview'. Journal of money, credit and banking, 20 (3) 559-588.

GHK (2004) 'An evaluation of phoenix fund support for community development finance institutions: a final report for the small business service' [online]. London, Small business service. Available at: http://www.sbs.gov.uk/content/analytical/evaluation/CDFI-Evaluation.pdf (Accessed 8.12.04).

Giddens, A. (1998) The third way: the renewal of social democracy'. Cambridge, Polity press.

Graham, T. (2004) 'Graham review of the small loans guarantee' [online]. London, HMT. Available at: http://www.hm-treasury.gov.uk/graham (Accessed 12.10.04).

Granovetter, M. (1985) 'Economic action and social structure: the problem of embeddedness'. American journal of sociology, 91 (3) 481-510.

Harvey, D. (1973) Social justice and the city. London, Edward Arnold.

Hess, M. (2004) ''Spatial' relationships? Towards a reconceptualisation of embeddedness.' Progress in human geography, 28 (2) 165-186.

HMT (2001) 'Enterprising communities: a tax incentive for community investment. a consultation document' [online]. London, HMT. Available at: http://www.hm-treasury.gov.uk/media/CC1/06/20.pdf (Accessed 10.10.04).

HMT (2004) HM Treasury. Promoting financial inclusion. London, The stationary office.

HMT (2005a) 'Budget 2005' [online]. London, HMT. Available at: http://www.hm-treasury.gov.uk/media/B5B/80/bud_05completereport_147.pdf (Accessed 16.03.05).

HMT (2005b) ‘Enterprise and economic opportunity in deprived areas: a consultation on proposals for a local enterprise growth initiative’ [online]. London, HMT. Available at: http://www.hm-treasury.gov.uk/media/A65/09/bud05_enterprise_economicopportunity_565.pdf (Accessed 01.12.05).

Hyndman, N., McKillop, D., Ferguson, C. and Oyelere, P. (2002) Credit unions in the uk: a study of their structure, growth and accountability. London. ACCA research report.

James, A. Gray, M. Martin, R. Plummer, P. (2004) ‘Commentary’. Environment and planning a, 36, 1901-1905.

Keeble, D. (1997) ‘Small firms, innovation and regional development in Britain in the 1990s’. Regional studies, 31 (3) 281-293.

Keys, P. and Thrift, N. (1980) ‘Industrial environments: a niche theoretic interpretation’. Urban studies, 17, 115-129.

Law, J. (1994) Organizing modernity. Oxford, Blackwell.

Lee, R. (1999) Local money: geographies of autonomy and resistance? in money and the space economy. Martin, R. (Ed) Chichester, John Wiley and Sons. 207-244.

Lee, R. and Leyshon, A. (2003) ‘Conclusions: re-making geographies and the construction of ‘spaces of hope’’. In Leyshon, A. Lee, R. and Williams, C. C. (Eds) Alternative economic spaces. London, SAGE.

Leyshon, A. and Lee, R. (2003) ‘Introduction: alternative economic geographies’. In Leyshon, A. Lee, R. and Williams, C. C. (Eds) Alternative economic spaces. London, SAGE.

Leyshon, A. and Thrift, N. (1994) ‘Access to financial services and financial infrastructure withdrawal: problems and policies’. Area, 26 (3) 268-275.

Leyshon, A. and Thrift, N. (1995) ‘Geographies of financial exclusion: financial abandonment in Britain and the United States’. Transactions of the IBG, 20 312-341.

Leyshon, A. and Thrift, N. (1996) ‘Guest editorial’. Environment and planning a, 28, 1150-1156.

Leyshon, A. and Thrift, N. (1997) Money/space: geographies of monetary transformation. London, Routledge.

Leyshon, A. and Thrift, N. (1999) ‘Lists come alive: electronic systems of knowledge and the rise of credit-scoring in retail banking’. Economy and society, 28 (3) 434-466.

Leyshon, A., Lee, R. and Williams, C. C. (Eds) (2003) Alternative economic spaces. London, SAGE.

Macmillan Committee (1931) Committee on finance and industry report. London, HMSO.

Marshall, A. (1930) Principles of economics. Eighth edition. London, Macmillan.

Marshall, J. N. (2004) ‘Financial institutions in disadvantaged areas: a comparative analysis of policies encouraging financial inclusion in Britain and the United States’. Environment and planning a, 36 241-261.

Martin, R. (1999) Money and the space economy. Chichester, John Wiley and sons.

Mason, C. M. and Harrison, R. T. (1997) ‘Business angel networks and the development of the informal venture capital market in the UK: is there still a role for the public sector’. Small business economics, 9 111-123.

Mason, C. M. and Harrison, R. T. (1999) ‘Financing entrepreneurship: venture capital and regional development’ in Martin, R. (Ed) Money and the space economy. Chichester, John Wiley and sons. 157-183.

Mason, C. M. and Harrison, R. T. (2001) ‘‘Investment readiness’: a critique of government proposals to increase the demand for venture capital’. Regional studies, 35 663-668.

Mason, C. M. and Harrison, R. T. (2002) ‘The geography of venture capital investments in the UK’. Transactions of the IBG, 27 427-451.

Massey, D. (1999) ‘Space-time, ‘science’ and the relationship between physical geography and human geography’. Transactions of the IBG, 24, 261-276.

Mathiason, N. (09.03.03) ‘Customers of no account’ [online]. London, The Observer, Business. Available at: http://observer.guardian.co.uk/business/story/0,,910220,00.html (Accessed 21.03.05).

Mayo, E. and Mullineux, A. (2001) ‘Bootstraps or braces? The regulation of community development finance institutions’. London, NEF.

Mayo, E. Fisher, T. Conaty, P. Doling, J. and Mullineux, A. (1998) Small is bankable: community reinvestment in the UK. York. Joseph Rowntree Foundation.

McGeehan, S., Forster, S. and Mayo, E. (2003) The power of information: opportunities for disclosure. London. Barclays/NEF.

Mosley, P. and Steel, L. (2004) 'Microfinance, the labour market and social inclusion: a tale of three cities'. Social policy and administration, 38 (7) 721-743.

NCCA (2004) 'CDFIs: providing capital, building community, creating impact: third edition' [online]. Philadelphia, National Community Capital Association. Available at: http://www.communitycapital.org/finance/cdfi-data-project.html (Accessed 26.06.05).

NCCA (2005a) CARS on the road: the rating system for CDFIs. Second edition. NCCA, Philadelphia.

NCCA (2005b) 'CDFIs side by side: CDFI trends and opportunities: sixth edition' [online]. Philadelphia, National Community Capital Association. Available at: http://www.communitycapital.org (Accessed 01.05.05).

NEF and Nicholson, B. (2003) 'Analysis of the need and demand for development funding of CDFIs in the West Midlands' [online]. Birmingham, Advantage West Midlands. Available at: http://www.advantagewm.co.uk/downloads (Accessed 04.05.06).

NEF, Urban Strategy Associates, West Midlands Enterprise, Local Government Centre (2003) 'West Midlands social enterprise: mapping social enterprises, increasing understanding of the sector and understanding needs'. Birmingham, West Midlands social economy partnership.

Nicholson, B. (2004) 'CDFI routes to sustainabilities'. Paisley University, Financing regional economy seminar, 12th May 2005.

NSFNR (1999) National strategy for neighbourhood renewal: policy action team 3. enterprise and social exclusion. London. HM Treasury.

O'Neill, P. and Gibson-Graham, J.K. (1999) 'Enterprise discourse and executive talk: stories that destabilize the company'. Transactions of the IBG, 24, 11-22.

OCC (2005) 'Community reinvestment act and interstate deposit regulation production regulations: cfr part 25' [online]. Washington, The office of the controller of the currency. Available at: http://www.occ.treas.gov/fr/cfrparts/12cfr25.htm#§%2025.28%20Assigned%20ratings (Accessed 1.11.05).

Palmer, H. with Conaty, P. (2002) Profiting from poverty: why debt is big business in Britain. London, NEF.

Pinsky, M. (1995) 'Coalition of lenders and investors help create the CDFI act of 1994'[online]. New Jersey. National housing institute. Available at: http://www.nhi.org/online/issues/79/coallaw.html (Accessed 07.12.05)

Pinsky, M. (2005) ‘CRA’. CDFA conference: money for change, Melton Mowbray (06.07.05).

Polanyi, K. (1957) The great transformation: the political and economic origins of our time. Boston, Beacon press.

Pollard, J. S. (2003) ‘Small firm finance and economic geography’. Journal of economic geography, 3 (4) 429.

Pollard, J. S. (2007) ‘Making money, (re)making firms: micro-business financial networks in Birmingham’s jewellery quarter’. Environment and planning a, 39, 378-397.

Porter, M. (1995) ‘The competitive advantage of the inner city’. Harvard business review (May-June) 55-71.

Purcell, D. and Cobb, S. (2004) ‘Credit unions on the financial landscape: geographical strategies of expansion and service’. The industrial geographer, 2 (1) 49-71.

Quinn Patton, M. (2002) Qualitative research and evaluation methods’. Third edition. London, SAGE.

Radcliffe committee (1959) Report of the committee of the monetary system. London, HMSO.

Ramsden, P. (2005) ‘Address to CDFA conference: money for change’. Community development finance association, Melton Mowbray (06.07.05).

Rogaly, B., Fisher, T. and Mayo, E. Eds. (1999) Poverty, social exclusion and microfinance in Britain. Oxford, Oxfam/New Economics Foundation.

Rose, G. (2000) ‘Hybridity’ in Johnston, R. J. Gregory, D. Pratt, G. Watts, M. (Eds) The dictionary of human geography. Fourth Edition. Oxford, Blackwell.

Rubin, J. and Stankiewicz, G. (2001) ‘The Los Angeles community development bank: The possible pitfalls of public-private partnerships’. Journal of urban affairs, 23 (2) 133-153.

Rubin, J. with Zielenbach, S. (2006) ‘What do we know? Research on outcomes and impacts in the CDFI field’. Available from author.

SBS (2003) Annual survey of small businesses: UK. London. Small business service.

SBS (2005) ‘Overview of the phoenix fund’ [online]. London, Small business service. Available at: http://www.sbs.gov.uk (Accessed 16.09.05).

Schoenberger, E. (1991) ‘The corporate interview as a research method in economic geography’. Professional geographer, 43 (2) 180-189.

Schoenberger, E. (1997) The cultural crisis of the firm. Oxford, Blackwell.

SETF (2007) ‘Reaching out: progress on social exclusion’[online]. London, Social exclusion task force. Available at: http://www.cabinetoffice.gov.uk/social_exclusion_task_force/documents/reaching_out/progress_report.pdf (Accessed 12.04.07).

ShoreBank (2004) ‘Our story’ [online]. Chicago, ShoreBank. Available at: http://www.sbk.com (Accessed 08.07.05).

Simpson, J. L. and Evans, J. (2005) ‘Benchmarking and crosschecking international banking economic and regulatory capital.’ Journal of financial regulation, 13 (1) 65-79.

SITF (2000) Social Investment Task Force. Enterprising communities: wealth beyond welfare. London, HMT.

Smith, K. (2006) ‘Problematising power relations in ‘elite’ interviews’. Geoforum, 37 (4) 643-653.

Stiglitz, J. E. and Weiss, A. (1981) ‘Credit rationing in markets with imperfect information’. American economic review, 71, 393-410.

Storey, D. and Wren, C. (2002) ‘Evaluating the effect of soft business support upon small firm performance’. Oxford economic papers, 54 (2) 334-365.

Storey, D. J. (1994) Understanding the small business sector. London, Thomson learning.

Summers, L. (02.03.1998) ‘Building emerging markets in America’s inner cities’ [online]. Remarks by Lawrence H. Summers Deputy Secretary of the treasury national council for urban economic development, Washington. Available at: http://www.ustreas.gov/press/releases/rr2262.htm (Accessed 09.06.06).

Taylor, M. (1999) ‘The small firm as a temporary coalition’. Entrepreneurship and regional development, 11, 1-19.

Taylor, M. and Thrift, N. (1983) ‘The role of finance in the evolution and functioning of industrial systems’ in Hamilton, F. E. I. and Linge, G. J. R. (Eds) Spatial analysis, industry and the industrial environment. Volume 3. Regional economies and industrial systems. Chichester, John Wiley and sons.

Taylor, M. J. and Thrift, N. (1982) ‘Models of corporate development’ in Taylor, M. and Thrift, N. (Eds) The geography of multinationals: studies in the spatial development and economic consequences of multinational corporations. London, Croom Helm.

Taylor, M. J. and Asheim, B. T. (2001) ‘The concept of the firm in economic geography’. Economic geography, 77 (4) 315-328.

Troni, L. and Kornblatt, T. (2006) City markets: business location in deprived areas. London, IPPR/Centre for Cities.

Uzzi, B. (1999) ‘Embeddedness in the making of financial capital: how social relations and networks benefit firms seeking financing’. American sociological review, 64 (4) 481-506.

Uzzi, B. and Gillespie, J. J. (2002) ‘Knowledge spillover in corporate financing networks: embeddedness and the firms debt performance’. Strategic management journal, 23 (7) 595.

Uzzi, B. and Lancaster, R. (2003) ‘Relational embeddedness and learning: the case of bank loan managers and their clients’. Management science, 49 (4) 383.

Van Osnabrugge, M. (2000) ‘A comparison of business angel and venture capitalist investment procedures: an agency theory-based analysis’. Venture capital, 2 (2) 91-109

Wilson committee (1979) The financing of small firms. London, HMSO.

Williams, C. C. (1996) ‘Local exchange and trading systems: a new source of work and credit for the poor and unemployed?’. Environment and planning a, 28, 1395-1415.

Williams, C.C. Aldridge, T. Tooke, J. (2003) ‘Alternative exchange spaces’. In Leyshon, A. Lee, R. Williams, C.C. (Eds) Alternative economic spaces, Sage, London.

Williams, C. C. and Windebank, J. (2001) ‘Beyond profit motivated exchange: some lessons from the study of paid informal work’. European urban and regional studies, 8 (1) 49-61.

Wintour, P. (19.07.2007) ‘Hain ‘wielding big stick’ to force 300,000 lone parents into work’ [online]. London, The Guardian. Available at: http://money.guardian.co.uk/work/story/0,,2129649,00.html (Accessed 19.07.07).

Woodroofe, K. (1962) From charity to social work in England and the United States. London, Routledge and Kegan Paul.