

Briefing Paper

Community Development Finance Institutions (CDFIs): credit where its due

There has been much debate since the financial crisis about increasing numbers of viable small-and-medium-sized-enterprises (SMEs) unable to access affordable credit from mainstream banks. Here I wish to provide a constructive insight into how SMEs may be able to access loan finance and create vital jobs.

Community Development Finance Institutions (CDFIs) provide finance to viable businesses that cannot access loan finance from mainstream financial providers and in so doing, preserve and/or create new jobs. CDFIs are therefore filling the finance gap left behind by the banks. Yet CDFIs remain relatively unknown in the UK despite many CDFIs being in existence for over ten years.

The number of UK CDFIs grew considerably with the introduction of the Phoenix Fund to provide enterprise finance in disadvantaged areas¹. CDFIs work to a double bottom line by realizing social as well as financial objectives and may be defined as independent finance institutions that provide capital and support to individuals and/or organizations at the edge of commercial margins to develop opportunity and wealth.

The UK CDFI trade Association, CDFA, agrees that there is growing need for enterprise finance in order to generate confidence, growth and jobs. But how can businesses find out

¹ Appleyard, L. (2011), 'Community Development Finance Institutions (CDFIs): Geographies of Financial Inclusion in the US and the UK'. *Geoforum*, 42(2) 250-258.

more about CDFIs? Information is available at the Community Development Association (CDFA) website about which CDFIs operate in different local areas².

The Coalition Government response to the lack of bank lending (and banking crisis more broadly) was to set up 'Project Merlin' which was established with the 4 major UK banks to produce a series reforms which were published by the Independent Commission on Banking in September 2011³. Overall, the reforms aim to improve both the stability and competition between UK banks. Yet it is paradoxical to increase equity in banks on the one hand and lend more to business on the other. The impact of Project Merlin on access to enterprise finance is likely to be limited as increased lending to SMEs is only a temporary feature and the lending target has already been missed.

Here I suggest a more radical approach for reform because as Steve Walker, Chief Executive of the Aston Reinvestment Trust⁴, a Birmingham based CDFI, has stated: *'If the banks aren't lending to small or even medium sized businesses ... Who is going to fill the gap?'* and where will economic growth come from if not the private sector?

If banks remain unwilling to lend to viable SMEs, CDFIs could act as a vehicle in which banks could lend just as in the US under the guidance of the Community Reinvestment Act (CRA). The CRA was introduced in the US in 1977 to prevent racial discrimination and red-lining by mainstream banks⁵. The introduction of a UK CRA, to prompt disclosure of banking activity and lending to SMEs would be a controversial move but perhaps a necessary one given the impact of the 2007 financial crisis and the changing level of financial exclusion in the UK.

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² See Community Development Association website for CDFI membership www.cdfa.org.uk

³ See CHASM briefing paper by Andy Mullineux on 'Project Merlin in context'

⁴ See Aston Reinvestment Trust website <http://www.reinvest.co.uk/>

⁵ See Appleyard, L. (2011), 'Community Development Finance Institutions (CDFIs): Geographies of Financial Inclusion in the US and the UK'. *Geoforum*, 42(2) 250-258 and CHASM briefing paper on 'Why the UK needs a Community Reinvestment Act (CRA)