Regional Studies

ISSN: 0034-3404 (Print) 1360-0591 (Online) Journal homepage: https://www.tandfonline.com/loi/cres20

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To cite this article: Lindsey Appleyard (2013) The Geographies of Access to Enterprise Finance: The Case of the West Midlands, UK, Regional Studies, 47:6, 868-879, DOI: 10.1080/00343404.2012.748979

To link to this article: https://doi.org/10.1080/00343404.2012.748979

Published online: 08 Jan 2013.

Regional Studies, 2013
Vol. 47, No. 6, 868–879, http://dx.doi.org/10.1080/00343404.2012.748979

Routledge Taylor & Francis Group | Regional Studies Association

The Geographies of Access to Enterprise Finance: The Case of the West Midlands, UK

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(Received December 2009: in revised form October 2012)

APPLEYARD L. The geographies of access to enterprise finance: the case of the West Midlands, UK, *Regional Studies*. Whilst there is a long history of credit rationing to small and medium-sized enterprises (SMEs) in the UK, the financial crisis has seen banks retreat further from lending to viable SMEs due to a reassessment of risk and lack of available capital. In so doing, the credit crunch is thought to be creating new geographies of financial exclusion. This paper explores the financial inclusion of enterprise through community development finance institutions (CDFIs) which provide loan finance to firms at the commercial margins in the West Midlands, UK. The paper concludes that CDFIs could partially address the financial exclusion of enterprise as an additional, alternative source of finance to that of mainstream banks.

Financial crisis Financial exclusion Community development Enterprise

APPLEYARD L. 企业融资管道的地理：英国西密德兰的案例研究，*区域研究*。在英国，中小企业（SMEs）的信贷配给已历史久远，但在金融危机中，银行却因对于风险的再评估以及缺乏可运用的资本，因而进一步紧缩对可行的中小型企业的借贷。于此，信贷紧缩被认为创造了新的金融排斥性地理。本文透过提供金融借贷给英国西密德兰商业边陲地带企业的社区发展金融机构(CDFIs)来探讨对企业的金融包容。本文结论道：CDFIs 做为主流银行之外的一个额外、替代性金融管道，可以部分处理对企业的金融排斥性。

金融危机 金融排斥性 社区发展 企业

APPLEYARD L. Les géographies de l'accès au financement des entreprises: étude de cas de la région des West Midlands, au Royaume-Uni, *Regional Studies*. Alors que le rationnement du crédit aux petites et moyennes entreprises (Pme) est de longue date au Royaume-Uni, le choc financier a vu les banques abandonner davantage leurs engagements de prêt aux Pme solvables suite à une réévaluation du risque et faute de capitaux disponibles. Par la suite, on considère que le resserrement du crédit s'accompagne des nouvelles géographies de l'exclusion financière. Cet article cherche à examiner l'inclusion financière de l'entreprise par le biais des institutions financières de développement communautaire (Community Development Finance Institutions: CDFI) qui fournissent des garanties de crédit aux entreprises aux marges commerciales dans les West Midlands, au Royaume-Uni. En guise de conclusion, l'article affirme que les CDFI, en tant qu'une autre source de financement complémentaire à celle des banques commerciales, pourraient faire face en partie à l'exclusion financière de l'entreprise.

Choc financier Exclusion financière Développement communautaire Entreprise

APPLEYARD L. Geografien der Verfügbarkeit von Unternehmensfinanzierung: der Fall der West Midlands in Großbritannien, *Regional Studies*. Die Rationierung von Darlehen an kleine und mittelständische Unternehmen (KMU) hat in Großbritannien lange Tradition, doch seit der Finanzkrise scheuen die Banken auch vor Darlehen an finanziell solide KMU zurück, da die Risiken neu bewertet werden und nicht ausreichend Kapital zur Verfügung steht. Hierdurch scheint die Kreditkrise neue Geografien der finanziellen Ausgrenzung zu erzeugen. In diesem Beitrag wird die finanzielle Eingliederung von Unternehmen mit Hilfe der Community Development Finance Institutions (CDFIs) untersucht, die Darlehen für wirtschaftlich marginalisierte Firmen in der britischen Region West Midlands finanzieren. Das Fazit lautet, dass CDFIs als zusätzliche bzw. alternative Finanzierungsquelle zu den etablierten Banken die finanzielle Ausgrenzung von Firmen teilweise lindern könnten.

Finanzkrise Finanzielle Ausgrenzung Gemeinschaftsentwicklung Firmen

APPLEYARD L. Las geografías del acceso a la financiación de empresas: el caso de West Midlands, RU, *Regional Studies*. Aunque el racionamiento del crédito para pequeñas y medianas empresas (pymes) en el Reino Unido tiene una larga tradición, la crisis financiera ha llevado a los bancos a reducir los préstamos a las pymes sólidas debido a una revaloración de los riesgos y falta de capital disponible. Por este motivo, parece ser que la crisis del crédito está creando nuevas geografías de exclusión económica. En este artículo analizo la inclusión financiera de empresas a través de las instituciones financieras para el desarrollo de los municipios

(CDFI) que ofrecen financiación para préstamos a empresas comercialmente marginalizadas de West Midlands, Reino Unido. Concluyo el artículo sosteniendo que las CDFI podrían solucionar parcialmente el problema de la exclusión financiera de las empresas como una fuente adicional y alternativa de financiación en vez del sistema bancario clásico.

Crisis financiera   Exclusión financiera   Desarrollo de la comunidad   Empresas

JEL classifications: G10, G28, G29, H81

INTRODUCTION

There is a growing literature on the financial crisis which began in 2007 (Aalbers, 2009a; Dymski, 2009; French *et al.*, 2009; Hallsworth and Skinner, 2008; Langley, 2008; Lee *et al.*, 2009; Martin, 2011; Sidaway, 2008; Wainwright, 2009; Wojcik, 2009; Wyly *et al.*, 2009). Whilst these debates within economic geography, economics and political economy have largely considered the relationships between financialization and individuals, less attention has been paid to the important issue of access to enterprise finance. This is surprising as firms have experienced particular challenges in accessing affordable mainstream finance since the start of the credit crunch (Bank of England (BOE), 2010; HM Treasury (HMT) and Department for Business, Innovation and Skills (BIS), 2010; Smith, 2010). It is believed that many microenterprises and small and medium-sized enterprises (SMEs) that were once considered viable and bankable by mainstream financial institutions have been excluded from accessing finance since 2007 and continue to be excluded from accessing affordable, mainstream finance (Pimlott, 2009; Sunderland, 2009, p. 1). Mainstream financial institutions' unwillingness to lend to individuals and businesses due to the lack of available capital and risk aversion is creating new and greater geographies of financial exclusion (French *et al.*, 2009). In so doing, the financial exclusion of SMEs may have serious implications for economic recovery and future economic growth, particularly when these firms make up a significant proportion of the UK's private sector employment (Economist, 2009, 2010; HMT and BIS, 2010). This paper seeks to extend debate on the financial crisis and the geographies of money and finance literature by exploring how the withdrawal of mainstream credit in the UK has redefined the concept of financial exclusion of enterprise, and the role that community development finance institutions (CDFIs) (which provide access to finance for enterprises in underserved markets) alongside a Community Reinvestment Act (CRA) may play in providing one solution to the increasingly significant finance gap.

The paper is structured as follows. The next section explores the mainstream finance gap and the significance of access to finance for enterprise, particularly since the start of the 2007 credit crunch. The third section highlights how CDFIs aim partly to fill the finance gap left behind by mainstream financial institutions' withdrawal from disadvantaged areas prior to the financial crisis and how since the 2007 credit crunch CDFIs are providing additional sources of finance to 'a new class of financially […] excluded' (French *et al.*, 2009, p. 295). The fourth section discusses current access to finance policies linked to CDFIs and the potential for introducing a CRA. The fifth section outlines the context of CDFIs within the West Midlands region of the UK, how they are providing a legitimate solution to the problems created by market failures prior to and during the financial crisis for viable yet excluded enterprises, and how a CRA could fill the finance gap further. The final section concludes that amidst this current financial uncertainty there are opportunities for enterprise to overcome barriers to finance via CDFIs which contribute towards a more financially inclusive landscape, stimulating economic growth and creating and/or preserving jobs in the process.

THE MAINSTREAM FINANCE GAP AND THE FINANCIAL EXCLUSION OF ENTERPRISE

Enterprise has been highly valued by successive UK governments (Bolton, 1971; Macmillan, 1931; Radcliffe, 1959; Wilson, 1979). Despite this, there is a long history of a small firm finance gap in the UK where banks fail to lend to viable businesses (Bolton, 1971; Macmillan, 1931; Radcliffe, 1959; Wilson, 1979). SMEs continue to be considered as the lifeblood of the economy. Indeed, the current UK coalition government believes at this time of economic uncertainty that:

> we need a[n economic] recovery led by sustained expansion in the private sector, […] Small and growing businesses are a vital part of the economic recovery.
>
> (Vince Cable, Secretary of State for Business, Innovation and Skills, and George Osborne, Chancellor of the Exchequer, cited in HMT and BIS, 2010, p. 3)

Despite the political rhetoric in support of SMEs, such enterprises have often found accessing finance a challenging process. This issue has become increasingly acute as a result of the recent credit crunch.

The UK finance gap that existed prior to the 2007 financial crisis in the supply and demand of loan finance for commercial and social enterprises (BOE, 2000, 2003; MAYO *et al.*, 1998; STOREY, 1994) has become even deeper with many SMEs experiencing financial exclusion that were previously considered viable (BOE, 2010; SMITH, 2010). UK mainstream banks have withdrawn further from widespread lending as they have lost the ability to lend capital due to a reassessment of risk (WAINWRIGHT, 2009). Whilst this 'flight to quality' is a feature of earlier recessions (LEYSHON and THRIFT, 1994, 1995), without affordable access to finance enterprises are unlikely to prosper, provide jobs and contribute towards economic growth.

Financial exclusion is broadly defined as lack of access to affordable financial products and services (DYMSKI, 2005). Financial exclusion has (until the recent credit crunch) been particularly prevalent in disadvantaged areas (MAYO *et al.*, 1998), to the extent that there was 'a systemic development of the geography of financial exclusion in the UK' (BRYSON and BUTTLE, 2005, p. 286). LEYSHON (2009, p. 155) has more recently considered the multidimensional nature of financial exclusion in the following five ways: 'access exclusion', for example, branch closure in moderate and low-income areas; 'condition exclusion', for example, whereby customers are rejected by credit scoring systems; 'price exclusion', for example, affordable finance; 'marketing exclusion', for example, targeting 'potentially profitable socio-demographic groups'; and 'self-exclusion', for example, where customers do not apply for finance as they: presume they will be denied, lack product awareness or due to cultural norms such as those who follow Sharia law (LEYSHON *et al.*, 2004; POLLARD and SAMERS, 2007). In the current financial crisis mainstream financial institutions may be exacerbating access and price exclusion through the use of condition tightening and credit scoring (BOE, 2010) creating a more widespread geography of financial exclusion across the UK.

There has been a recent shift towards condition tightening by banks to exclude enterprises from accessing finance. This is due to banks' lack of capital which could deteriorate further under new Basel III rules and reduce their propensity to take risks (WEARDEN, 2010). Mainstream financial institutions continued failure to offer affordable credit facilities to small businesses, particularly in deprived neighbourhoods, represents market failure and credit rationing. This is, in part, the result of mainstream banks assessment of risk through the use of credit scoring which in effect red-lines areas in which not to lend to increase the rewards and mitigate risk in loans being defaulted (LEYSHON and THRIFT, 1999). The use of credit scoring has arguably exacerbated 'access' financial exclusion as banks had become increasingly risk averse prior to the credit crunch (LEYSHON and THRIFT, 1999; LEYSHON, 2009). The global financial crisis is believed to be intensifying such difficulties in accessing finance (SEAGER, 2009; SUNDERLAND, 2009) thereby creating 'a new class of financially (re)excluded' (FRENCH *et al.*, 2009, p. 295). For example, businesses that successfully applied for finance in 2007 may not be able to access that same funding now as the mainstream lenders' assessment of risk and clients that are considered viable has changed (OFFICE OF NATIONAL STATISTICS (ONS), 2011a). Research by the UK Office of National Statistics (ONS, 2011a) shows greater demand for finance between 2007 and 2010 (35–42% of SMEs sought loan finance). Of those SMEs that sought loan finance, the majority approached banks. In 2007, 90% of loan finance applications to banks were successful. This fell to 65% in 2010. In effect due to the increasing numbers of businesses seeking finance, more businesses were refused finance. Many of those that have been refused business finance may use personal lending to finance their business in the form of personal finance or financial support from family and friends (SMITH, 2010). In effect, mainstream enterprise lending, or the lack of, has created greater inequality between those that are bankable and those considered unbankable, exacerbating uneven access to finance and creating new geographies of financial exclusion.

FILLING THE FINANCE GAP: COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS (CDFIS)

Additional financial providers such as CDFIs have become instrumental in providing financial products and services to excluded yet viable individuals and firms (APPLEYARD, 2011; BRYSON and BUTTLE, 2005). The role of CDFIs is to fill the spaces which the mainstream financial providers do not fill. UK CDFIs were one of the 1997 UK Labour government financial inclusion strategies which aimed to stimulate and support financially excluded enterprises in disadvantaged areas through providing loans and business support as deprived areas have least access to finance (NATIONAL STRATEGY FOR NEIGHBOURHOOD RENEWAL (NSFNR), 1999). In this way, CDFIs were considered an additional vehicle for the supply of debt finance to enterprise rather than simply an alternative source of finance (FULLER and JONAS, 2003).

CDFIs were originally established partly to target and serve the financially excluded by providing access to credit and, in doing so, to 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 (BRYSON and BUTTLE, 2005). 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

(Appleyard, 2011). These institutions are involved in higher-risk lending as they lend to viable businesses that banks feel unable to lend to and can do so through receiving policy guarantee funds to underwrite the risk. Consequently, CDFIs often have to manage relatively high default rates. They use lending criteria developed in mainstream financial institutions but modify the criteria to target financially excluded enterprises and to include social criteria to reach their double bottom line (Bryson and Buttle, 2005). CDFIs can offer enterprises access to affordable credit because of their assessment of the clients through old-fashioned relationship banking methods and enhanced due diligence to determine the risk–reward ratio on an application by application basis rather than credit scoring (Bryson and Buttle, 2005). 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, p. 279)

In other words, CDFIs aim to be sustainable but their double bottom line means that there may be tension between their social and financial objectives in actually achieving it. Loans sanctioned by CDFIs are re-lent on repayment which multiplies economic wealth in the local community (Bryson and Buttle, 2005). CDFIs 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). In this way, CDFIs can maximize social impact by operating revolving loan funds using public support to underwrite risk.

There is currently an unequal geography of CDFI provision as many CDFIs have been established ad-hoc and identified by local needs (Appleyard, 2011; Bryson and Buttle, 2005). For example, CDFIs serve different markets such as start-up businesses, women, ethnic minorities and particular disadvantaged geographical areas. Whilst this approach is designed to reach those who are the most financially excluded, there may be other viable SMEs that do not fit the lending criteria set by their local CDFI which means that they may remain financially excluded. With relatively high default rates and a current gap in the provision of policy guarantee funds to the CDFI sector, the result is that CDFIs only contribute to overcoming financial exclusion in some parts of the UK with the exception of a few national CDFIs for particular groups, for example, young people can access loans from The Prince's Trust. Due to their double bottom line, CDFIs are highly complex and so tensions within their operations will always exist (Bryson and Buttle, 2005). They aim to be financially viable and consequently do not finance extremely high-risk business propositions. This means that financially excluded firms which operate below the lending threshold set by CDFIs will remain financially excluded. It is difficult to assess the true size and scale of the finance gap, but given the scale and depth of the crisis in the UK, it is probable that demand exceeds supply (ONS, 2011a). With the availability of funds for CDFIs from the UK government supported by the Phoenix Fund (which ran from 1999 to 2006), it was assumed that as an additional 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 can and are experiencing financial exclusion, as information asymmetries exist between CDFIs and mainstream financial institutions. This makes it challenging for most CDFIs to secure finance other than grants and charitable donations for their operations (Bryson and Buttle, 2005). In this way, CDFIs have to justify that they are both reaching the financially excluded and are financially viable. Yet, they cannot reach significant geographical scale without additional resources such as public funding to cover risk which is increasingly difficult to secure.

Access to finance for enterprise is an increasingly significant issue for many UK SMEs, particularly since the credit crunch. Whilst CDFIs originally emerged in response to the withdrawal of mainstream financial provision for SMEs in disadvantaged areas, more recently they are experiencing increasing demand from financially excluded enterprises that were once considered viable by banks in relatively affluent areas. As such, the concept of financial exclusion is being redefined and as a result the UK CDFI sector has widened its remit to respond to the particular problems caused by the financial crisis.

ACCESS TO FINANCE POLICIES

One impact of the financial crisis has been the financial exclusion of enterprises that were once considered viable by mainstream financial institutions. The UK coalition government is supportive of private sector enterprise and is pressurizing banks to lend to enterprises for them to start-up or grow (Department for Business, Innovation and Skills (BIS), 2012; HMT, 2011; Independent Commission on Banking, 2011). Project Merlin was designed with the major UK banks (Royal Bank of Scotland, Lloyds Banking Group, HSBC, Santander and Barclays) to improve both the stability and competition between UK banks whilst increasing business lending. Yet, it is paradoxical to increase equity in banks and lend more to business. The impact of Project Merlin is likely to be limited as increased lending to SMEs is only a temporary feature and the lending target has already been missed by £1 billion (BOE, 2012). The latest initiative, Funding for Lending, is designed to incentivize banks to lend to enterprise and to consumers for mortgages (HMT and Bank of England (BOE), 2012).

Despite numerous government and bank pledges to provide credit to enterprise, many firms have yet to benefit from the availability of affordable bank lending (Stewart, 2012; Tyler, 2011; Winnett, 2011). If the banks are not willing to lend to SMEs, CDFIs are well placed to act as a vehicle in which banks could lend just as in the United States under the guidance of a Community Reinvestment Act (CRA).

The CRA was introduced in the United States in 1977 to prevent racial discrimination and red-lining by mainstream banks in the housing mortgage market (Appleyard, 2011, Aalbers, 2009b; Marshall, 2004). However, the CRA has been blamed for the 2007 global financial crisis as it was assumed that it approved loans to subprime borrowers who are defined as having a poor credit history and low income (Aalbers, 2009b). Aalbers (2009a, 2009b) demonstrated that a more accurate definition of subprime is lending at higher interest rates regardless of income. Therefore, in fact, the CRA 'promote[d] fair lending to all borrowers' rather than inappropriate lending to those on a low income (Aalbers, 2009b, p. 350). A UK CRA similarly needs to promote financial inclusion, which is why CDFIs would be an effective vehicle for banks to support and meet the conditions of a CRA.

Another rationale for a UK CRA is the lack of coordinated and significant public sector funding for CDFIs. There are a number of schemes that support CDFI activities and that CDFIs may apply for which reflects the diversity of the sector, although only schemes for enterprise are outlined here. The Enterprise Finance Guarantee (EFG) is a loan guarantee scheme to facilitate lending to firms with an annual turnover of up to £41 million seeking finance of between £1000 and £1 million and includes start-up and existing businesses, SMEs and large firms (HMT, 2009, 2011). In addition, the Small Loans for Businesses (SLFB) offer up to £50 000 for small businesses through CDFIs (HM Government (HMG), 2008; HMT, 2009) and as many CDFIs are already providing this service they are well placed to adopt this scheme. The coalition government has replaced the Regional Development Agency (RDA) funding schemes with a highly competitive £1.4 billion Regional Growth Fund (RGF) designed to support:

> a fairer and more balanced economy – one that is not so dependent on a narrow range of economic sectors, is driven by private sector growth and has new business opportunities that are more evenly balanced across the country and between industries.
>
> (HMG, 2010, p. 5)

In the first round of bidding for the RGF, almost 450 applications were received (BIS, 2011). The UK CDFI trade association, the Community Development Finance Association (CDFA), was successful in its application to create a £60 million loan fund to lend to CDFIs in April 2011. However, by summer 2012 the CDFA was yet to receive funding from the scheme. The 'Big Society Bank' known as the Big Society Capital Group is yet to be finalized but looks set to be a less viable option for CDFI support in that its key aim is to provide finance for civil society organizations (Cabinet Office, 2010).

Overall, the current UK CDFI funding situation is piecemeal and needs to be widened to include all sectors and geographic areas (including Scotland, Wales and Northern Ireland) and the conditions of each scheme make them exclusive rather than inclusive. The recent Breedon Report (Breedon, 2012) proposed that government funding initiatives be simplified and welcomed more diverse non-bank forms of debt finance though CDFIs were not mentioned specifically. This strengthens the case for one UK national core fund for CDFIs and potential for a UK CRA. This would add clarity and consistency for SMEs wishing to access finance and CDFIs as without significant public policy support it is unlikely that CDFIs will become part of the longer-term financial landscape and a significant minority of SMEs will remain financially excluded.

METHODOLOGY

The paper explores the West Midlands region of the UK as it provides an example of how the dynamics of financial exclusion are changing within an area that was relatively economically depressed prior to the financial crisis and the impact that the crisis has had on CDFI activities. The UK's West Midlands region comprises the counties of the West Midlands, Shropshire, Staffordshire, Warwickshire, Worcestershire and Herefordshire. The West Midlands is suffering the effects of the financial crisis disproportionately compared with other UK regions due to its reliance on manufacturing and public sector employment (Martin, 2011) with over 9% of the population of the region unemployed compared with the UK average of 7% (ONS, 2011b). The West Midlands has an enterprise deficit in relation to other regions of the UK as the birth rate and growth of SMEs within the West Midlands is below the national average (Advantage West Midlands (AWM), 2004; Deloitte and Touche, 2002). Deloitte and Touche (2002) found that the finance gap in West Midlands was significant and this was a key reason for lack of SME activity in the region. By 2009, access to finance remained a key issue (Memorandum from Fair Finance Consortium Ltd cited in House of Commons West Midlands Regional Committee, 2009):

> Financially excluded businesses are those that the banks don't want to be involved with. One interpretation of the current situation is that suddenly the bar has been raised and that there are now many more financially excluded businesses. The community finance sector,

> arguably the one financial services sector that knows how to work with financially excluded businesses still seems excluded from being part of the solution.
>
> (section 2.5)

The widening finance gap for SMEs, particularly in the West Midlands, extends the rationale for the UK CDFI sector given the strength of their knowledge of local markets and working with viable yet financially excluded firms.

This paper builds on empirical research undertaken between October 2005 and December 2009. This involved twenty-two interviews with key actors at UK CDFIs and within the UK CDFI sector which were transcribed fully and analysed using NVivo. The empirical research was also comprised of UK banks, five UK CDFIs, the CDFA and a number of active clients of one UK CDFI. The interview data consisted of information of the organizations' development, operations (including loan process) and strategy. These data were supplemented with the UK CDFA annual survey, UK policy reports plus regional policy documents and national press reports. Together these methods give greater credibility and robustness to the research. The next section will explore how CDFIs in the West Midlands region of the UK already provide part of the solution to the increasingly significant finance gap and the limitations of this without significant support.

FINANCIAL INCLUSION OF ENTERPRISE WITHIN THE WEST MIDLANDS

In the wake of the financial crisis, the concept of financial exclusion is being reconfigured by mainstream financial institutions reassessment of risk. Here the concept of financial exclusion is explored through CDFIs which are continually evolving to meet the shifting financially excluded enterprise markets.

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.
>
> (NEW ECONOMICS FOUNDATION (NEF) and NICHOLSON, 2003, p. 10)

From 1999 to March 2012, the West Midlands RDA, Advantage West Midlands (AWM), had been working with CDFIs in the whole region by identifying and bridging the finance gaps for SMEs and by coordinating financial resources in the West Midlands (AWM, 2004, p. 125). In 2005, AWM, with Barclays bank, supported the creation of a consortium of CDFIs and other loan providers in the West Midlands. In addition, it developed the Advantage Small Loan Programme (ASLP) and a follow-on Small Business Loans programme (September 2009–March 2011) which were designed pre-credit crunch to support further provision of region-wide access to finance for enterprise up to £50 000 by supporting enterprise CDFIs and other loan providers to access capital and/or revenue for their operations and was designed to act as a follow on from the UK centralized Phoenix Fund (for more on the Phoenix Fund, see APPLEYARD, 2011).

The support from AWM enabled CDFIs and other loan providers located within the West Midlands to cover the entire region. There are currently six CDFIs and loan providers in the West Midlands operating in a variety of markets and serving both urban and rural populations (Table 1). In 2010, West Midlands CDFIs lent almost £5 million to 260 microenterprises, SMEs and social enterprises (FAIR FINANCE CONSORTIUM, 2011). The average loan approved in 2010 was £18 544, which suggests that the market gap is for SME finance rather than micro-enterprise loans, which tend to be for smaller sums (FAIR FINANCE CONSORTIUM, 2011). The 2008–2010 figures show increasing demand for loan finance from West Midlands CDFIs. It has not been possible, however, to show figures for West Midlands CDFI loans outstanding or source West Midlands bank data. A case study of one West Midlands based CDFI, the Aston Reinvestment Trust (ART), will now be explored further to

Table 1. West Midlands community development finance institutions (CDFIs) and loan providers

West Midlands CDFIs	Type of loan[a]	Loan size	Geographic areas served
Aston Reinvestment Trust (ART)	M, SE, SME	£10 000–50 000	Birmingham and Solihull
Black Country Reinvestment Society (BCRS)	M, SME	£10 000–50 000	Black Country and Staffordshire
Coventry and Warwickshire Reinvestment Trust (CWRT)	M, P, SE, SME	£500–50 000	Coventry and Warwickshire
Impetus	M, SE, SME	£1000–50 000	Herefordshire, Worcestershire and Shropshire
Midlands Community Finance (MCF) Loans	P	£1000–10 000	Derbyshire and East Staffordshire
Black Country Enterprise Loan Fund (BCEF)	M, SME	£0–10 000	Black Country

Note: [a]M, microfinance; P, personal finance; SE, social enterprise; SME, small and medium-sized enterprise.

contextualize the development and potential future of CDFIs within the ongoing financial crisis.

ASTON REINVESTMENT TRUST (ART)

ART was established in 1997 as an independent social financial institution to provide finance for enterprise; it operates in Birmingham which is the metropolitan hub of the West Midlands. 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 it helped to persuade the Labour government to support UK CDFIs as part of its financial and social inclusion agenda. CDFIs were therefore seen as the 'new [policy] animal' to fill the niche left behind by mainstream finance in the UK (Chief Executive, UK CDFI, January 2006). In many ways ART was ahead of the rest of the CDFI sector as it was 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.
>
> (Aston Reinvestment Trust (ART), 2006, p. 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 (microenterprise, SME and social enterprise) in Birmingham and Solihull having extended its geographic coverage over the years in line with policy demands from public sector funders. It initially provided loans to microenterprise and SMEs from £2000 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 Solihull. This strategic decision was intended to shift ART away from deals below £10 000 which had been high risk and not cost-effective, and in response to the changing market needs. It was originally envisaged that social enterprise loans would help to balance the risk of lending to small businesses. Yet social enterprise loans have been slow to materialize. The loan portfolio is divided into 15% of loans to social enterprise and 85% to loans for microenterprise and SMEs, which comprise 50% start-up and 50% existing businesses. Prior to the recent recession, ART had a bad debt rate of 22.6%, which was similar to the now defunct Small Firms Loan Guarantee Scheme (SFLG) default rate. This has now increased to 31% and remains within the limits of funders, but it reduces the ability of ART to relend loans that have been repaid (ART, 2010). The imbalance in risk is mitigated with the use of policy guarantee funds to underwrite the higher risk in lending to businesses with a high social impact. The higher default rate may reflect evidence that banks are lending to SMEs with greater security and track record and many SMEs are struggling to survive in the current economic conditions (ONS, 2011a).

As ART was founded prior to the Phoenix Fund, funding for ART's initial 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, however, also targeted policy guarantee funds to underwrite risk and made careful use of these at an early stage from the public sector. In this way, it aimed to move towards operational sustainability from the outset whilst recognizing the need for scale in its operations, policy guarantee funds for depth of reach in targeting underserved markets and in more challenging economic conditions such as at present:

> 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.
>
> (Steve Walker, Chief Executive, ART, January 2006)

ART, after expansion, has now reached a level of 90% operational sustainability. Funds obtained from the UK government's Phoenix Fund 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. By taking additional risk, ART has fulfilled its role in lending to underserved markets while remaining true to its mission of supporting local jobs for local people.

DEMAND FOR ENTERPRISE FINANCE DURING THE CREDIT CRUNCH

Since June 1997, ART has lent almost £10 million to over 530 businesses and created and/or preserved over 4200 jobs (ART, 2011). In 2010–2011 financial year, 55% of ART loans were to businesses under three years old, and 25% of loans were made to black and minority ethnic businesses (ART, 2011). Since the start of the credit crunch ART has seen increased demand for its services. Steve Walker, ART's Chief Executive, stated that:

> There is very little profit in small business loans for the banks, so they tend to be cautious about offering them. The credit crunch has only accelerated a trend which started 20 years ago. A bank may consider a business

> 'risky' because it has no trading history, or the owners want to change direction, or because the owner has insufficient assets to guarantee a loan.
>
> (Birmingham Post, 2011, p. 18)

Therefore:

> The vital question for the UK economy [...] is if the banks aren't lending to small or even medium sized businesses and CDFIs lack the resources to step in, as our experience shows, who is going to fill the gap?.
>
> (Steve Walker, Chief Executive, ART, December 2009)

The increase in demand for West Midlands CDFI loans is generally reflected across the UK CDFI sector (Community Development Finance Association (CDFA), 2012a, 2012b). The CDFA (2012b) reported that the UK CDFI sector made £23 million worth of loans to over 1500 enterprises during the 2011–2012 financial year. This is a marked increase on previous years even with the reduction in CDFI members. CDFA (2009) stated that since 2007 banks are unable to meet the increased demand for finance and as a result:

> many CDFIs are coping with a substantial increase in enquiries and loan applications by customers who would have been served by banks when the economy was healthier.
>
> (p. 4)

Many SMEs remain unaware of CDFI finance, which points to the need for a more cohesive movement (CDFA, 2012a; Wheatley, 2012):

> I believe there is probably a lot more demand out there that ART could do but people don't know that ART exists [...].
>
> (Director, ART, January 2006)

Increasing demand for finance may reflect the maturity of the sector as it becomes established (BIS *et al.*, 2010), but is more likely to reflect the current financial climate and inability of SMEs to access finance from banks. It appears that the credit crunch is seeing CDFIs serve customers that were once considered bankable when the economy was growing as more CDFIs are seeing greater numbers of viable enterprises and are able to secure their loans. Moreover, this increase may reflect the need for additional alternative sources of finance beyond conventional locations of geographic and social disadvantage:

> to counter what are seen to be the regressive social effects of the cost of these market-based financial services [...] to create a responsible, inclusive and diverse financial economy.
>
> (Leyshon *et al.*, 2004, p. 638)

The majority of the UK's CDFIs were set up to encourage renewal in under-invested communities. Now, as the economic landscape is changing, CDFIs may no longer be seen as the lenders of last resort, but dynamic organizations which could provide a partial solution to an increasingly significant finance gap, if only they receive the appropriate investment.

This section has explored how West Midlands CDFIs and UK CDFIs are and could fill the widening finance gap further. The current credit crunch has shown how vital access to debt finance (particularly up to £50 000) is for SMEs at this time. UK CDFIs remain in a transition period in terms of strategy and funding. There is as yet no final decision regarding the way in which CDFIs will be funded in the longer term, if at all, despite the recognition that to achieve social outcomes, public or private subsidy is essential to underwrite risk as CDFIs are not sustainable without it (BIS *et al.*, 2010). The UK coalition government has stated that:

> backing enterprise by providing finance to those who struggle to get credit from mainstream lenders meets a vital need [...] we are committed to helping the community finance sector flourish and grow.
>
> (Prisk, 2010)

However, there is often a disconnection between rhetoric and actions as has been seen historically with the persistent finance gap for SMEs and the flurry of recent government initiatives that have so far failed to make a significant impact.

TIME FOR A UK COMMUNITY REINVESTMENT ACT (CRA)?

The introduction of a UK CRA and disclosure of banking activity would be a controversial move but perhaps a necessary one given the impact of the 2007 financial crisis and scale of exclusion in the UK (Leyshon and Thrift, 1995, p. 330; French *et al.*, 2009; Tyler, 2011). The CRA cannot be viewed as 'a panacea for financial exclusion' due to the complex nature of financial exclusion in the UK (Marshall, 2004, p. 242). Yet without collaboration and cooperation from other financial institutions, under the regulation of a UK CRA it is unlikely that CDFIs will 'ever constitute a comprehensive and systematic tool for combating [financial] exclusion' (Bryson and Buttle, 2005, p. 286). This is despite CDFIs showing that they have the potential to be an appropriate model for underserved markets.

A UK CRA would, first, force all banks to lend to SMEs as banks would refer those that were denied access to finance to CDFIs (who would then be responsible for the loan process in return for funding) as a UK CRA would divert bank funding which it would have lent to SMEs to CDFIs which would make extra resources available for CDFIs to cope with the additional geographical coverage, markets and risk beyond disadvantaged areas as the nature of financial exclusion changes. Second, a CRA would make banks lending more transparent and accountable for their activities.

Despite UK CDFIs actively responding to meet the (geographically uneven but largely) increased demand for finance in the current financial crisis, CDFIs have yet to receive 'coordinated government support' beyond the Phoenix Fund (Ainsworth, 2009; CDFA, 2009, 2010, 2012b; NEF, 2009, p. 3). Current CDFI activities are restrained, which means that they have a relatively limited impact both in terms of financial inclusion and on the wider financial system. Many SMEs continue to be unaware of CDFI finance which points to the need for a more cohesive movement (CDFA, 2012a; Wheatley, 2012):

> It's not always the easiest sector to understand and [...] it's hard [...] to get clear messages or policies because they are trying to address too many things.
>
> (RDA Consultant, June 2006)

> 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.
>
> (Director, CDFI, June 2006)

A CRA would follow suggestions made by the Breedon Report (Breedon, 2012) that access to finance needs to be simplified as SMEs are often unaware or confused by the array of policy initiatives available.

The key issue here is if the banks are not lending, then CDFIs are willing to take on the risks the banks are not, but only with sufficient policy cover to cover the risk of default. A CRA would drive banks to support CDFI activities to lend to viable business propositions that could preserve and/or create jobs. CDFIs could provide a partial, legitimate solution to the financial exclusion of enterprise, though not without additional resources, greater geographical coverage and bank engagement.

CONCLUSIONS

This paper has explored the impact of the 2007 financial crisis on access to finance for enterprise in the UK. Whilst there is a literature surrounding the financial crisis on personal finance, access to enterprise finance has received less attention. In response, this paper explored how the credit crunch has exacerbated banks' unwillingness to lend to viable commercial and social enterprises thereby intensifying financial exclusion of enterprise in the UK and redefining the concept of financial exclusion in the process. In so doing, it has explored how an additional financial sector in the form of CDFIs, which largely emerged in the 1990s to fill the finance gap created by bank withdrawal, have been well placed to serve a growing financially excluded market in the current financial crisis. One of the important findings of this paper has been that CDFIs are hybrid financial institutions due to their double bottom line and that a dichotomy between mainstream and alternative finance does not exist.

The paper has shown that the current economic crisis continues to form new geographies of financial exclusion, yet CDFIs have the potential to provide a partial solution to the increasingly significant finance gap. To do this, coordinated and appropriate support for additional alternative financial providers is essential in order to create a financially inclusive landscape. A core national fund to increase scale and geographical coverage of CDFIs is essential to create greater clarity in their mission, underwrite risk and increase awareness of additional sources of finance. While a UK CRA could increase the scale and impact of CDFIs, it could also make more SMEs financially included. Therefore, with greater cooperation between banks and CDFIs, greater even coverage across UK could be reached to add both social and economic value to the economy. Yet there is a divergence between political rhetoric, the solutions to bridge the finance gap and the scale of the issue.

The financial crisis has highlighted the extent and depth of the SME finance gap which existed prior to the crisis (Deloitte and Touche, 2002) and since 2007 has continued to grow (BOE, 2012). Given that the UK coalition government is highly supportive of the private sector to provide employment, it may prove fruitful for them also to support additional financial providers for enterprise as a way of creating jobs and a cost-effective alternative to welfare payments. As this paper has demonstrated, UK CDFIs are providing a viable solution for financially excluded enterprises and could play a more significant role in contributing to future economic growth, but only with appropriate policy support. Moreover, further research and debate surrounding access to enterprise finance is an important narrative that needs to be explored further.

Acknowledgements – The author would like to thank both the Editors and the anonymous referees whose comments strengthened the paper considerably, and for the contributions of those who gave up their time to participate in this research funded by the Economic and Social Research Council (ESRC) CASE studentship award (Grant Number PTA-033-2004-00021). The usual disclaimers apply.

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