# Street UK
A micro-finance organisation
# Lessons Learned
From its first three years' operations

**Rosalind Copisarow**
Chief Executive, 2000 - 2004

**Supported by the Calouste Gulbenkian Foundation and the European Micro-finance Network**

# Contents


**About the author and editor** 2

**Foreword** 3

**Acknowledgements** 4

**Executive summary** 5

**Street UK Lessons Learned**
> Introduction 10

**Background**
> Street UK's history 12
> Lending results 13
> Key achievements 14

**1 Micro-entrepreneurs in the UK**
> UK micro-entrepreneurs in context 16
> Case study: Michael 18
> Principal needs and appropriate services 20
> Key lessons about micro-entrepreneurs 22

**2 Financial services required by micro-entrepreneurs**
> Insurance products 24
> Savings products 24
> Loan products 25
> Case study: Beverly 27

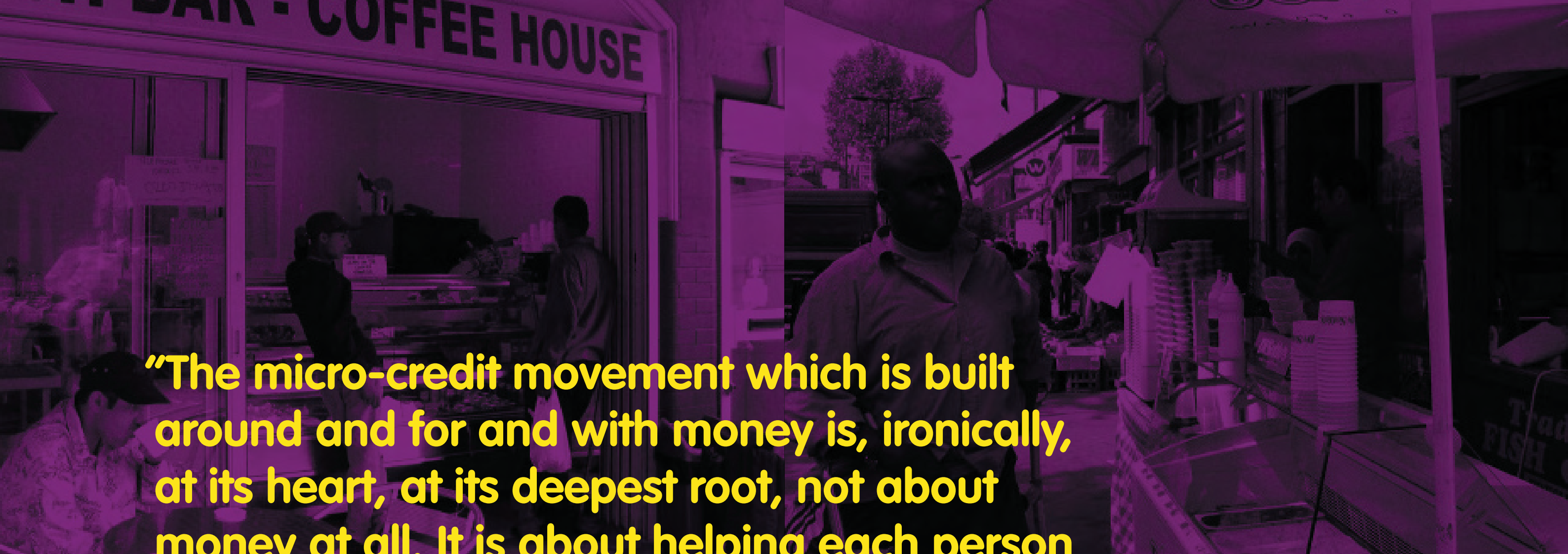
**3 Street UK's loan and business support product**
> Current product and service offered 29
> Key lessons from lending 30
> Key principles of business advice and support 30
> Table: Loan product variables tested 32

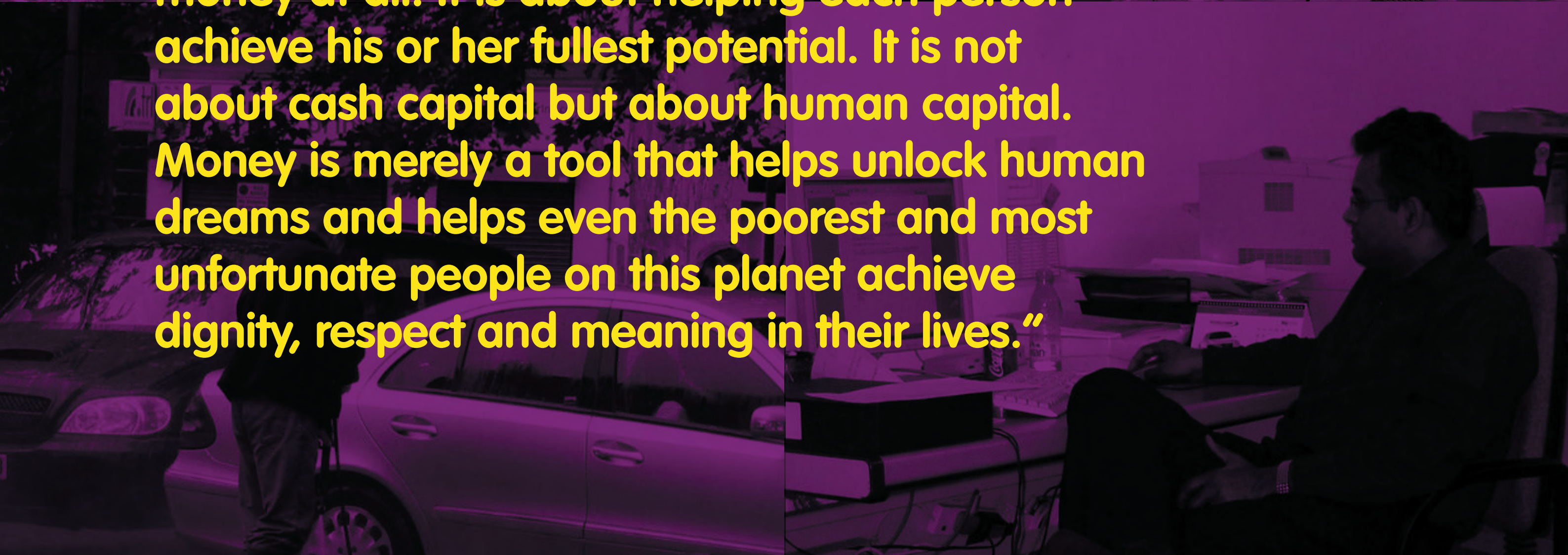
**4 Street UK's organisational development**
> Key elements of first business plan 35
> Business plan-related lessons learned 35
> Strategies for sustainability 38
> Key elements of current business plan 39

**5 Funding issues**
> Government funding 42
> Bank funding 44
> Foundation funding 45
> Individual funders' issues 48
> Conclusions 49

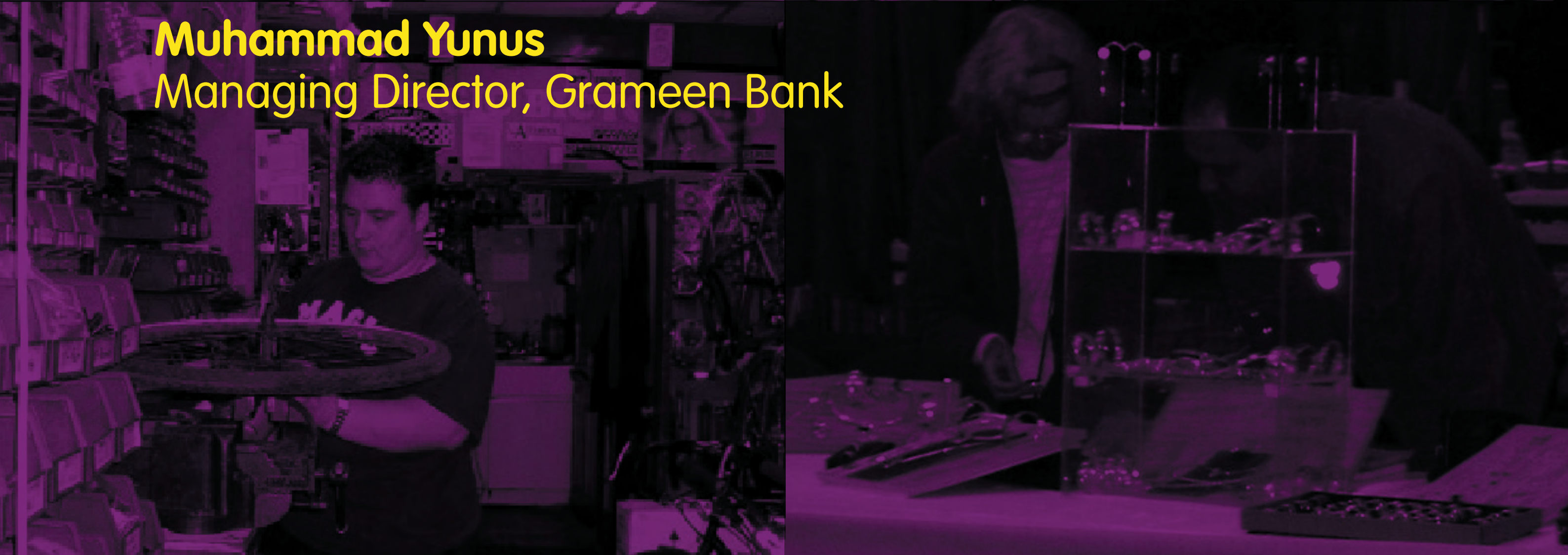
**6 Policy and regulatory issues**
> Micro-entrepreneur issues 51
> Micro-finance organisation issues 56
> Government organisational issues 58

**7 Areas for further research** 61



**"The micro-credit movement which is built around and for and with money is, ironically, at its heart, at its deepest root, not about money at all. It is about helping each person achieve his or her fullest potential. It is not about cash capital but about human capital. Money is merely a tool that helps unlock human dreams and helps even the poorest and most unfortunate people on this planet achieve dignity, respect and meaning in their lives."**



**Muhammad Yunus**
Managing Director, Grameen Bank

# The Author

## Rosalind Copisarow

After a 15 year career in banking with Citigroup, HSBC and JP Morgan, Rosalind founded and developed two micro-finance organisations: Fundusz Mikro, Poland, in 1994 and Street(UK) in 2000.

During its first 5 years, Fundusz Mikro made over 40,000 loans, creating at least 10,000 new jobs, and became fully self-sustaining by 1999. In the UK, in the course of developing the operations of Street(UK) and Street(North East), Rosalind has contributed to the development of a UK micro-finance sector, by creating and sharing best practices, and by promoting and influencing key legal, regulatory, tax and funding improvements to government policy. Her publications include "The Application of Micro-finance Technology to the UK" (1999) and "Self-Employed people in the Informal Economy: Cheats or Contributors?" (2004).

Rosalind has also co-founded, advised or served on the boards of CGAP - the World Bank-led unit for the development and dissemination of best practice in micro-finance in Asia, Africa, Latin America and Eastern Europe; the Micro-finance Centre for Central and Eastern Europe, a networking, training, consulting and policy research and advocacy organisation now representing nearly 100 practitioner organisations in the region; the Community Development Finance Association, the trade association for Community Development Financial Institutions in the UK; and several other social enterprises, including Via3.Net and WETV.

Rosalind's undergraduate degree was gained in Human Sciences from Oxford University. She also holds an MBA from the Wharton School of Finance, and an MA in Latin American studies, as a Fellow of the Lauder Institute, University of Pennsylvania. In 2000, Rosalind was awarded the Officer's Cross of the Order of Merit of Poland for her contributions to poverty alleviation and economic development.

# The Editor

## Sarah Forster

Sarah Forster has over fifteen years of international development and microfinance experience. Since 2001, Sarah has been a Programme Director at the New Economics Foundation (NEF) where she leads NEF's work on local economic development. This includes consulting, research and advocacy on government policy and practical initiatives to support local enterprise and financial systems that benefit disadvantaged people and communities.
She was also Director of the Inner City 100, an initiative to promote the role of local business in inner city regeneration.

From 1992-2001, Sarah was at the World Bank. During that time she managed local development and microfinance investment projects in Eastern Europe, East Asia and West Africa. She spent four years (1996 – 2000) based in Bosnia and Herzegovina where she led the design and implementation of a national microfinance programme which supported the establishment of eight financially viable microfinance institutions together disbursing over £100 million and serving more than 50,000 clients in 2004. Sarah also advised on the creation of a national microfinance investment and support facility in Afghanistan.

Sarah has served on the Boards of the Microfinance Centre for Eastern & Central Europe and the New Independent States, the European Microfinance Network and Aspire Micro Loans for Business Ltd., in Northern Ireland. She is the co-author of "A Feasibility Study into a Wholesale Intermediary for Community Development Finance in the UK", April 2002, and the "State of Microfinance in Eastern & Central Europe and the New Independent States" published by the World Bank in April 2003.

Sarah has a BA from Cambridge and an MA from Columbia University, New York.

# Foreword

Give a man a fish, it is said, and he can feed himself for a day. Give him a fishing rod, and he can feed himself and his family for a lifetime. But lend a man or woman the money to buy a fishing rod, sewing machine, carpentry tools, computer, taxi or catering equipment, and they can not only choose their own means of livelihood, but also, through their loan repayments, recycle the capital they have borrowed onto the next person. On top of this, their tiny interest payments mean that, if the lending organisation reaches sufficient scale, it can cover the entire administrative cost of operation. As a result, it is able to serve more and more people without further recourse to donor aid.

This in essence is what micro-finance is about - empowering people with hand-ups rather than hand-outs, and providing a sustainable solution to global poverty and financial exclusion. For this reason, it has arguably become one of the most important economic development tools and financial innovations of the 20th century. In over 100 countries now, micro-finance organisations are helping tens of millions of people across the poverty line into self-employment and financial independence. And this, after only 30 years since the first tentative experiments were made.

About 14 years ago, we founded ADIE in France, to bring the concept to the industrialised world, having seen a different, perhaps less visible, but equally insidious kind of poverty there. It had many causes: the well-intentioned welfare state had nevertheless created a serious dependency problem; the massive burden of regulation on small businesses resulted in those who could not cope being forced into the shadow economy; and very low ceilings on legal lending rates deprived a whole population group from access to mainstream finance, relegating them to the predatory lending practices of loan sharks.

With over 11,000 ADIE clients across the country now, it is clear that people in France, like Bangladesh or Bolivia, can benefit enormously from the kind of support provided by micro-finance organisations, despite the major differences in their respective environments. This finding has been further endorsed by the subsequent establishment of a growing number of micro-finance organisations in other industrialised countries - among them Street UK in Britain. And this, in turn, has led to the recent creation of the EMN, a network of Western European practitioners in the field.

The EMN's purpose is not only to provide a forum for the exchange of best practice in the industry, but also to undertake research and advocacy for specific changes to the EU member countries' policy and regulatory environments. The latter are a significant factor behind both the social and financial exclusion suffered by micro-entrepreneurs, and the extra burdens placed on the micro-finance organisations trying to serve them on a sustainable basis. This is why I very much welcome, and why the EMN is delighted to co-sponsor, the publication of this first report on the subject by an experienced micro-finance practitioner in both developing and developed economies.

Rosalind Copisarow's report not only includes an honest account of Street UK's difficulties and the strategies that the organisation has developed within the constraints of the current environment. She also provides important insight into the underlying policy shifts that are necessary by government, banks, foundations and regulatory bodies, to create an environment where micro-entrepreneurs can graduate into mainstream society and business, and where micro-finance organisations can properly serve them over the long term.

As we enter 2005, declared by the United Nations as the Year of Micro-credit, we need to recognise the magnitude of the task ahead, and to challenge some of our most commonly held principles and practices, if we are to truly build an inclusive financial sector for an inclusive society. It is within this context that I warmly recommend this report to practitioners, funders and policy-makers alike, as a first step in raising those fundamental questions that need to be asked, and starting the debate that will hopefully lead to some real and lasting improvements in access to economic opportunity for all.

**Maria Nowak**
President, Association pour le Droit a l'Initiative Economique (ADIE)
President, European Micro-finance Network (EMN)

## Acknowledgements

Street UK is greatly indebted to a large number of individuals and institutions:

For the start-up and development funding it has received for its operations, Street UK would like to express its sincere thanks to the following organisations:

*Esmee Fairbairn Foundation, SBS/Phoenix Fund, Leaside Regeneration, Northern Rock Foundation, Tudor Trust, City Parochial Foundation, Network for Social Change, World in Need, Scottish Enterprise, Calouste Gulbenkian Foundation, John Ellerman Foundation;*

And for the capital which it has on-lent to its clients, it would also like to thank:

*Barclays Bank, HBOS/Bank of Scotland, Alliance & Leicester, Co-operative Bank, Northern Rock plc and Newcastle Employment Bond.*

There are a number of individuals whom Street UK would like to thank for their exceptional personal support. These include:

*David Baker, Aaron Barbour, John Battle, Paul Brickell, Peter Burt, David Carrington, Ronald Cohen, Nicholas Colloff, Fiona Ellis, Tim Glass, Bill Hallahan, Wayne Horkan, Joel Joffe, Peter Kelly, Ed Mayo, Bharat Mehta, Frederick Mulder, David Pike, Susan Rice, Stephen Taylor, Peter Thomson, Stephen Timms, Kate Wallace, Martyn Williams, Michael Young and Roger Young.*

Street UK would also like to thank the *Inland Revenue* and the *Social Exclusion Unit* for the fruitful working partnerships that have resulted in the refinement of many of the policy proposals contained in this report, as well as *Wragge* and *Linklaters law firms* for their pro bono legal services.

From other community finance practitioners in the UK, Street UK has learned at least as much as others have learned from its own operations. It would especially like to acknowledge the contributions that *Aspire*, a micro-credit organisation in Northern Ireland; *Community Finance Solutions*, a network of local funds in England; *Change*, an initiative of the London & Quadrant Housing Association; and *BizFizz* in Easington, Co. Durham; have made to its thinking and operations design.

For the production of this report, Street UK would like to express its great appreciation to the *Calouste Gulbenkian Foundation* and to *the European Micro-finance Network* , who have generously sponsored the publication and supported its distribution to all those interested in micro-finance not only in the UK, but throughout Europe and other industrialised countries; to the *Esmee Fairbairn Foundation* for encouraging this report to be written and promoting the development of a learning culture in the voluntary sector; and to *Sarah Forster, Programme Director* at the *New Economics Foundation*, which undertook an independent evaluation of Street UK on behalf of Esmee Fairbairn Foundation. With her in-depth understanding of our operations gained from this work, Sarah provided invaluable editorial assistance in the production of this report.

Finally, and most importantly, Street UK would like to pay tribute to its clients, whose loyalty and positive endorsement of its work have been the constant motivator for it to continue its efforts to give them proper support on a sustainable basis. This report is dedicated to them and to all the millions of hard-working, multi-talented micro-entrepreneurs like them, who are the backbone of our society and one of the most deserving of all population groups to receive public support.

# Executive Summary

**Street UK was launched in September 2000 with the mission of supporting low-income self-employed people and owners of tiny businesses within the UK, through the provision of micro-finance. Its original business plan was adapted from the international model of micro-finance, which emphasises scale and sustainability as the means to achieving permanence and impact. Since starting its operations, Street UK has modified its business plan substantially in the light of the significant differences it has found between the environment in the UK (and industrialised countries in general) and the conditions prevailing in poorer economies.**

**This paper sets out Street UK's experience in terms of:**
> The main constraints it has encountered in the UK environment, which have called for a change to the original business model;
> The solutions and plans it has developed to respond to these constraints;
> The areas where policy changes are needed to support both micro-entrepreneurs and the community development financial institutions (CDFIs) that serve them;
> The remaining knowledge gaps where further research is needed.

## Characteristics of micro-entrepreneurs

- The number of micro-entrepreneurs in need of loan finance and sufficiently creditworthy to receive a loan from a micro-finance organisation has been found to be much lower than expected. This is due to both demand and supply factors.

  The demand factors include:

  - Low levels of financial literacy and cashflow management skills;
  - High levels of over-indebtedness to credit card companies, money lenders or retail stores;
  - No or very low levels of savings;
  - Lack of adequate insurance protection due to its unavailability or very high cost.

  On the supply side:

  - The credit market has been found to be highly competitive and the availability of credit widespread amongst poorer communities;
  - Although the terms and conditions of much of this credit may be inappropriate, expensive and even irresponsible, they are nevertheless well packaged, with high initial appeal to potential customers.

- Micro-entrepreneurs have also been found to be in great need of good quality and appropriately delivered business support, in order for their businesses to survive and grow, within an environment of:

  - High levels of costly regulation and red tape which make it very difficult for them to develop their businesses on a fully legitimate basis, 'forcing' many to operate in the grey market and remain excluded from access to mainstream financial services;
  - Significant disincentives within the tax and benefits system to graduate from welfare to self-employment and build their savings;
  - A very mature, competitive marketplace, whatever their trade or profession.

## Products and services required

- Street UK has found that micro-entrepreneurs in the UK need tailored support beyond the level at which they are considered by charities and policy-makers to be 'in need', all the way through the grey market transition process that gives them eventual access to mainstream financial and business support services.

- They need a range of financial services, not just loans, to achieve a number of objectives, including: insurance to reduce risks; and savings to build assets, which are key to long term, secure improvements in their lives and their businesses.

- Loans are a critical element for those micro-entrepreneurs who do not first need financial literacy, debt management or social support, and have been shown to have a significant positive impact on their own lives, their families' future prospects and on new, (unsubsidised) job creation within the local community. However,

  - The loans need to combine responsible lending features with attention to the packaging elements that make dangerous money-lender products so attractive;
  - Loans need to be made individually, group loans having been found not to work on a large scale, mostly due to the lack of peer group support and peer pressure at levels prevalent in developing countries.

This requirement to make loans 'one at a time' has had a substantial adverse effect on its ability to achieve both high loan volume and repayment and low transaction costs.

> A raft of financial and business support services are also needed to complement the loan capital, in order to help micro-entrepreneurs become mainstream small businesses. These are shown in the table below.

| Finance | Advice | Business support | Trade services | Other facilities |
|---|---|---|---|---|
| Insurance<br>Savings<br>Loans / leases<br>Equity / grants | Legal / regulatory<br>Tax / benefits<br>Debt management<br>Business development | Consultancy<br>Training courses<br>Self-help tools | Book-keeping<br>Tools / Equipment rental<br>Equipped premises rental<br>Marketing, printing<br>Secretarial services | Library / internet support<br>On-site creche / interpreter / translation to support utilisation by disadvantaged communities |

> In terms of the business development advice itself, the emphasis needs to be on helping micro-entrepreneurs to focus on:

> Customer-/revenue- led, rather than investment-led, growth;

> Progress by means of many small manageable steps, rather than by fewer larger jumps, each one being more risky;

> Cashflow, before profitability or asset-building;

> Risk identification and management;

> A transition strategy to graduate from grey market, cash-based activities to formal, fully regulated small businesses.

> Many micro-entrepreneurs are highly motivated to support members of their local communities more disadvantaged than themselves, and provide very effective assistance to people that government agencies and community organisations find hard to reach directly. However, because this is usually achieved by incorporating their assistance within their business activities, they are not recognised as social entrepreneurs and their businesses carry heavy unrelated costs. A separation of the two elements of the business is therefore required, together with grant and technical support services for social enterprise development, accessible by micro-entrepreneurs.

## Organisational development issues

> The three key components to achieving a high impact, sustainable micro-finance organisation are: high loan volume to achieve scale, high loan repayment rates and low transaction costs.

> The main reasons that high loan volume has been difficult for Street UK to achieve are described above. In practice, this has meant that, by the end of year 3, it was only able to make 259 loans, considerably below its original projections. This result is nevertheless in line with the experience of other community finance organisations within the UK, USA and Western Europe.

> As regards loan repayment rates, Street UK's original long-term loss projections have also had to be revised up to 8-10% p.a. This is for three principal reasons:

> The average loan officer calibre and relationship with their clients is generally not as strong as is needed to overcome the clients' lack of financial literacy and cashflow management skills;

> The client 'empowerment' factor, which derives from being given unique support by the micro-finance organisation, is greatly weakened by the supply of alternative, initially attractive services;

> The repayment enforcement process is undermined by a frequently ineffectual court process, for this type of case.

- In relation to transaction costs, the two categories of costs which Street UK has found to be much more expensive than anticipated, particularly in terms of time taken, are travelling between branches and fundraising beyond a single regional government boundary. Both of these factors have contributed to the reasons that Street UK has, for the time being, shifted its business model from a national to a (West Midlands) regional scale organisation, the other big factor being the lack of loan volume, which has created an unsustainably high subsidy requirement. Street UK's organisational objective has therefore had to reduce its emphasis on maximising economies of scale, in order to keep the level of subsidy within achievable fundraising limits.

- Overall, although Street UK no longer believes that micro-finance organisations in the UK can achieve scale and sustainability with a single loan product only, it does still believe that sustainable organisations can be created by a combination of:

> Adding to their revenue streams through new product development for micro-entrepreneurs, or pursuit of complementary new client markets. Street UK, for example, has developed a back-office loan administration service for other community loan funds, which is now providing a significant proportion of its trading income;

> Finding synergies with other organisations through partnerships, mergers and cost-sharing arrangements;

> Reducing costs through greater use of volunteers, secondees and non-executive directors, as well as technology in place of staff.

## Appropriate support from funders

- There is a substantial immediate need for core funding for CDFIs' operations, until they are able to become financially self-sufficient. Although foundations have been very helpful in providing much of the initial funding for this source of support, the government should now increase its role of providing ongoing core funding, both because community finance institutions now have a small but significant track record in providing effective support to their clients and because they will be delivering some of the government's key objectives.

- There is a great need for the type of funding provided to be based on the principles of venture philanthropy, particularly in the early years of an organisation's development, allowing institutional capacity-building.

- With micro-finance lying between philanthropy and commercial finance, the most appropriate funding in the longer term will come from intermediary forms of finance, along a spectrum ranging from completely philanthropic to completely commercial. This is still an embryonic market, where there are major opportunities for the development of new financial instruments ranging from patient equity capital to semi-commercial debt. Some of these instruments may be able to be created through partnerships between private, public and voluntary sector funders.

- In order to ensure that there is sufficient interest by investors to place funds into each of these new intermediary forms of finance, the fiscal incentives need to be appropriate to the level of financial sacrifice required from the investors, relative to the return they could have obtained from a commercial investment. In other words, the system of tax relief should be designed as a sliding scale and equated to the level of

'donation-equivalent' involved with each intermediary instrument.

> Beyond fiscal incentives, the government also needs to provide a range of additional return-enhancing or risk-reducing incentives, as well as some mandatory regulation to leverage a reasonable minimum level of further investment into CDFIs from both commercial and non-commercial sources.

> For financial institutions, the provision of intermediary finance will require changes to their internal organisation structure to enable them to respond appropriately to the needs of the market, while for foundations and trusts, changes to their investment policies, and possibly to the regulatory framework for investing their endowment capital, will be needed.

> In addition to providing financial support, funders can play a very helpful role in a number of other ways, particularly commercial banks, whose own activities have much in common with those of micro-finance organisations.

## Policy and regulatory issues

Based on Street UK's experience, and that of other organisations with which it has worked, there are a number of policy issues which it believes need to be addressed, if low income micro-entrepreneurs are to be able to advance into mainstream society and develop their businesses to become sufficiently creditworthy for CDFIs to support them into mainstream bankability. These issues are classified into those which directly affect the micro-entrepreneurs themselves, those which affect the organisations that support them and those which are specific to the way government works.

In summary, Street UK's recommendations amount to five major paradigm shifts in public policy thinking:

> A new approach to poverty alleviation which recognises the importance of building savings and assets, the need for protection from predatory lending practices and the objective of designing a tax and benefits system which incentivises people out of dependency more than compensates people in it.

> A new approach to helping low income, self-employed people out of the informal economy, based on cutting taxes, cutting red tape, increasing enforcement and increasing specialised support.

> A recognition of the social and economic value provided by CDFIs, through the creation of a long term, stable mechanism for supporting the sector. This should be based on an understanding of the cost-effectiveness of the value CDFIs provide in relation to many different areas of current government expenditure, including enterprise creation, deprived area regeneration, employment, finance, social services, health and law and order.

> An expansion of the current tax incentives for investors in CDFIs, in order to incentivise a whole raft of intermediary forms of wholesale finance, along a spectrum between fully philanthropic and fully commercial.

> A much more market-driven approach by government in its support of this sector, in terms of:

> Reconfiguring its internal organisation structure to effectively address cross-cutting issues that otherwise fall through the cracks between different government departments.

> Making much more use of the knowledge base and delivery capacity of local community organisations, in its provision of public services; i.e. significantly increasing the number and scope of partnerships between the public and voluntary sectors.

> Setting output targets and programme rules that are far more closely related to the measures that will *actually* achieve its objectives, so that community organisations can be funded to undertake the services that will have the greatest impact.

# Introduction

## This report is intended to be a public learning tool for all those interested in the provision of financial services to low income, self-employed people in the UK.

**Specifically, the document describes the main lessons learned by Street UK, the first micro-finance organisation in Britain to attempt to provide a UK-wide service for self-employed people and owners of tiny businesses unable to access mainstream business and finance services. In August 2000, Street UK received a major grant of £1.3m from Esmee Fairbairn Foundation (EFF), a further £1.2m of other grant facilities from foundations and government bodies, and £1.6m of loan facilities from commercial banks. These enabled it to start its operations from scratch. At that time, Street UK was also a pioneer organisation in the nascent community finance or 'CDFI' (1) sector. Although credit unions, enterprise agencies, charities, credit card companies, money lenders and commercial banks were all serving micro-entrepreneurs to some extent already, the premise of Street UK was that there was nevertheless a gap in the market of appropriate support for the tiniest of businesses (with up to 5 employees) that could be delivered on a sustainable basis (2).**

**Street UK's objective was to see if it could apply, within the UK, many of the elements of the typical business model used for the provision of micro-finance in developing countries (3), as this model had been so successful in reaching millions of people, helping them out of poverty and into financial independence, and doing so on a cost-covering basis. This depended on achieving high loan volume, high loan repayment rates, low transaction costs and high social and economic impact for each client assisted. Despite its prior market research and consultation with a range of experts, it became clear within a year of Street UK's operations that its business model needed substantial amendments. Furthermore, it was uncertain as to whether its objective of creating a single, national-scale, sustainable organisation was achievable even with these amendments, unless significant changes were also introduced to the policy and regulatory environment affecting both micro-entrepreneurs and the financial institutions serving them.**

**Having now made a number of significant changes to its business model, Street UK believes its future operations are set to develop in the best way possible within the current UK environment. This report aims to give a picture of the main lessons Street UK has learned throughout its history, including the way these have changed its business model.**

**The report is laid out as follows:**

The **Background** sections summarises Street UK's history, lending results and key achievements.

**Chapter 1 -** offers lessons about the client market, describing micro-entrepreneurs in the UK and what Street UK has learned about the nature of their requirements.

**Chapter 2 -** offers lessons about the required products and services, outlining the nature of the financial and business support services that best meet these requirements.

**Chapter 3 -** offers lessons from providing loans, advice and support, focussing on the key elements of the loan and business support product which Street UK has developed for the UK market.

**Chapter 4 -** offers lessons about the business model, commenting on the main organisational development issues, including Street UK's business model.

**Chapter 5 -** offers lessons about the terms and conditions of support needed from funders, providing a perspective on the most of appropriate support from funders.

**Chapter 6 -** offers lessons about the policy and regulatory changes needed, highlighting specific problems with the current system and recommending solutions.

**Chapter 7 -** points to lessons still to be learned, identifying areas where further research is needed.

---

(1) The Community Development Finance Association defines a CDFI or Community Development Financial Institution as a sustainable, independent financial institution that provides capital and support to enable individuals or organisations to develop and create wealth in disadvantaged communities or underserved markets.

(2) Sustainability is here defined as the capacity of an organisation to cover all of its cash costs of operation, including loan losses, overheads and cost of capital, with income generated from its clients. Sustainable interest rates mean interest rates charged to clients on their loans which are sufficient for the lender to achieve sustainability over the medium-long-term.

(3) The typical elements of the business model in developing countries are described in Section 4, but include building organisations of substantial size (in order to maximise economies of scale); building them as independent, stand-alone, financially sustainable institutions; offering group loans, where a number of borrowers are jointly and severally liable (in order to increase the loan volume, loan repayment and social impact of lending); and usually offering finance only, as opposed to finance attached to non-financial support.

# Background

**As context to the rest of the document, which sets out the main lessons that Street UK has learned, this Background section provides the key facts, through:**

> A brief chronology of Street UK's history
> The specific results of its lending activities and
> A summary of its overall achievements.

# Street UK's History

Street UK was launched in September 2000 with a mission to provide financially-excluded micro-entrepreneurs in the UK with a range of high quality, sustainable, specialised financial services, designed to protect them from failure and to support their development until they graduate to mainstream financial institutions. Like other new businesses (and CDFIs), Street UK's initial years of operation have been a time of market testing, experimentation, product development and learning. During this time, Street UK has developed and adapted its business model to the realities of implementation, the actual demand from its target market and its relative strengths as an organisation within the CDFI sector. As such, it has proven itself to be a dynamic, learning organisation. The table below summarises the main phases in Street UK's history.

| Period | Main Activity | Key Events |
|---|---|---|
| Phase I:<br>April 1998 - Aug 2000 | **Preparation** | > Trips by UK practitioners, business people and community experts to Fundusz Mikro (4), Poland to advise on its applicability to UK<br>> Study tour of US/Canadian micro-enterprise lending programmes<br>> UK market research; business plan developed; fundraising for pilots |
| Phase II:<br>Sept 2000 - Dec 2001 | **1st pilots; unLTD** (5) | > Official launch of Street UK<br>> Sept'00–March'01: preparation for opening of the first pilot branches in Glasgow, Newcastle and Bradford (staff recruitment, preparation of loan documentation, marketing); March'01: first loans made<br>> March'01: appointment of Rosalind Copisarow as CEO of unLTD on the basis of a merger with Street UK, to make grants to social entrepreneurs as well as loans to micro-entrepreneurs<br>> Dec'01: Rosalind resigns as CEO after lack of clear support for the proposed (unLTD/ Street UK) merger |
| Phase III:<br>Jan 2002 - Oct 2002 | **Stock-taking; Amended business plan** | Funding halted: unLTD funding discontinued, EFF funding frozen while new business plan developed; Phoenix Fund (6) bid declined<br>> Recognition of difficulties of UK enterprise culture, low loan volume, high loan delinquencies and high transaction costs<br>> Closure of Glasgow and Bradford branches; HQ (50% unLtd-funded) staff redundancies; stock-taking / decision whether to continue<br>> Development of new business plan, with emphasis on individual (vs. group) lending; branch locations geared to areas of higher population density and reduced difficulties in travel; greater focus on business support services; introduction of wholesale services and policy work<br>> Opening of second pilot branches in Birmingham and London |
| Phase IV:<br>Nov 2002 - March 2004 | **2nd pilots; Operating refinements; Wholesale, policy work** | > Unfreezing of EFF support<br>> Further refinements to lending and business support services, with new credit assessment and approval process<br>> Improved delinquency management and repayment performance<br>> Nov'02: StreetLab created as label for Street UK's R&D and policy work<br>June'03: StreetServe launched as back-office support service for community loan funds |
| Phase V:<br>April 2004 onwards | **New, post-pilot business plan** | > Development of 2004-2007 business plan, consolidating resources and focusing on expanding retail operations within West Midlands only, developing further wholesale services and rationalising policy work<br>> Newcastle branch becomes independent and London branch is closed |

(4) Fundusz Mikro, a Polish micro-finance organisation, was founded by Rosalind Copisarow in 1994 and developed into a national, fully sustainable organisation by 1999. It was in turn adapted from the Bangladeshi and Bolivian micro-finance organisations, Grameen Bank and Banco Sol, respectively. Following the strong endorsement of UK visitors to Fundusz Mikro, a number of its key features were incorporated into the design of Street UK. For further information, see www.funduszmikro.com.pl.

(5) This was a new charity formed by seven non-profit organisations each of which support social entrepreneurship. unLTD was selected as the preferred candidate to receive the Millennium Awards Legacy Fund, a £100 million endowment offered by the Millennium Commission to enable the continuation of the Millennium Awards and Fellowship Scheme. The purpose of unLTD was to provide grants to social entrepreneurs involved in the regeneration of their communities. Street UK could see the potential benefits to both organisations of a merger with unLTD. These included cost savings from running the two activities with a single management and branch structure and many positive synergies for clients through the broader range of activities, as well as (rarely available) secure, long-term, mission-related funding for Street UK. The risks, however, were that the merger might not ultimately be approved and that Street UK's operations would suffer a period of neglect meantime. The Board and funders of Street UK reviewed the potential benefits and risks, and ultimately

# Lending Results

As of March 2004, Street UK had made 259 loans worth £606,000 and had just over 100 current clients. Though these results are a fraction of its original projections (7), they are nevertheless in line with those of other CDFIs serving a similar market.

After three years in operation, Aspire, which lends to micro-entrepreneurs in Northern Ireland, had disbursed 233 loans, while the East End Micro-credit Consortium (8), which lends to low-income women in East London, had disbursed a total of 240 loans between its four member organisations.

## Street UK's Lending Results 2001-2004

| | Year ended 31 March 2002 | Year ended 31 March 2003 | Year ended 31 March 2004 |
|---|---|---|---|
| **Loans Disbursed** | | | |
| Number of loans disbursed | 70 | 80 | 105 |
| Cumulative number of loans disbursed | 74 | 154 | 259 |
| Amount disbursed £ | 131,250 | 147,422 | 321,668 |
| Cumulative value of loans disbursed (£) | 137,250 | 284,672 | 606,340 |
| Number of first loans | 60 | 74 | 73 |
| Average loan size disbursed (£) | 1,875 | 1,843 | 3,064 |
| Growth in loans disbursed (%) | - | 14 | 31 |
| Growth in first loans (%) | - | 23 | -1 |
| **Loan Portfolio / Current Clients** | | | |
| Number of loans outstanding | 59 | 104 | 148 |
| Number of active loans/current clients | 59 | 88 | 103 |
| Total gross loan portfolio outstanding (£) | 85,997 | 148,675 | 303,539 |
| Total net loan portfolio outstanding (£) | 85,997 | 103,795 | 212,324 |
| Average loan size outstanding (£) | 1,458 | 1,430 | 2,051 |
| Growth in number of active loans (%) | - | 49 | 47 |
| Growth in net loan portfolio (%) | - | 21 | 105 |
| **Loan Repayment Performance** | | | |
| Average 30 day collection rate (%) | - | 63 | 83 |
| Portfolio at risk (past 30 days due) | - | - | 14 |

Notes:
- The number of active loans and net portfolio value excludes those loans which are more than 180 days in arrears and are written-off for accounting purposes.
- Portfolio at Risk is defined as the (outstanding balance in arrears over 30 days + total gross outstanding principal restructured portfolio)/(total outstanding gross portfolio).
- Collection rate and portfolio at risk figures are as of December 2002 and December 2003. The 2003/4 net loan loss rate on Street UK's portfolio is <10% p.a.

supported Street UK's management in pursuing this opportunity, provided that Street UK's activities were not suspended or seriously jeopardised beyond the period required to agree the unLTD merger and receive the legacy fund. Rosalind Copisarow was short-listed as a candidate for CEO of unLTD and offered the position in March 2001, on the basis of a merger with Street UK. After nine months, however, it became clear that there was insufficient support among unLTD's board and the Millennium Commission for the merger and that continued efforts to implement it could potentially jeopardise both unLTD's bid and Street UK's future. Rosalind therefore resigned as CEO of unLTD in December 2001, to devote her full time to Street UK.

(6) The Phoenix Fund is a dedicated government grant fund that was created in 2000 to support CDFIs. It is managed by the Small Business Service and its emphasis is on stimulating enterprise in deprived areas. After three annual bidding rounds in which over £40 million has been disbursed to over 60 CDFIs, the Fund will now be discontinued and the responsibility for supporting CDFIs passed down to the Regional Development Authorities (RDAs). Street UK was heavily involved in making the case for the creation of a national fund (due to the need for economies of scale) and in recommending appropriate grant-giving criteria.

(7) Street UK originally projected a 7 year growth path, resulting in a national branch network, and a fully self-supporting institution with 20,000 clients, together borrowing £40 million.

# Key achievements

Despite not coming close to its original loan projections, Street UK has nevertheless been a key contributor to the creation and development of the UK community finance sector. Specifically:

### Retail

Street UK has developed an effective business support and loan product which has helped over 1,000 micro-entrepreneurs with advice or loans, many borrowers taking successive, incremental loans and significantly improving their lives and business prospects, as well as creating new jobs (9) and providing services in their local communities.

It has also developed specialist knowledge and support for 'grey market' micro-entrepreneurs (10) in transition between cash-based income-generating activities and fully regulated small businesses.

### Wholesale

Street UK has contributed to the development of a UK community finance sector, and strengthened this sector through the provision of a leading edge wholesale support service, StreetServe, that provides a 'micro-finance in a box' framework and back-office loan administration service to other community loan funds. The unique added value of this service is its design and development from a (retail) practitioner's perspective. After 7 months of marketing this income-generating service, StreetServe now has 5 current or imminent clients and another 6 prospects, together representing 14% of the estimated potential market.

Street UK has also been proactive in advancing many principles and practices now adopted and accepted by practitioners and funders, respectively. These include: the charging of sustainable interest rates to its clients; the use of strict delinquency and default measures; the allocation of costs on a fully-loaded basis; and the validity of leveraging public funding for its operations with private capital for on-lending to clients. These measures have served to provide a more conservative and transparent basis for the reporting of performance and a more efficient use of non-commercial capital.

Street UK has also shared its learning experiences internationally, resulting in the incorporation of many of its features and lessons learned into other micro-finance programmes in Eastern and Western Europe, Australia/New Zealand and USA.

### Policy

Street UK has worked with regulators, policy-makers and funders to develop a more enabling policy environment for micro-entrepreneurs and individuals unable to access mainstream financial services, as well as for the organisations that support them. This includes its contributions to: the Charity Commission's proposed categories of permitted activities now incorporating the prevention (as well as alleviation) of poverty and the development of communities; the creation of the new Community Interest Company legal entity for social enterprises; the introduction of Community Investment Tax Relief for investors in CDFIs; the creation of the Small Business Service's Phoenix Fund to provide core funding from central government for CDFIs; and the Inland Revenue's stance on the informal economy, which has resulted in an in-depth investigation into the motivations and obstacles facing grey market entrepreneurs.

It has also pioneered a social lending structure for commercial banks and promoted a venture philanthropy approach by foundations.

---

(8) The East End Micro-credit Consortium comprises: StreetCred, the Tower Hamlets' Homeless People's Campaign, Account 3 and Environment Trust.

(9) Street UK estimates that on average, 1 new full time job is created by its clients with every 4 loans and 1.25 full time jobs are protected with every 2 loans.

(10) The 'grey market' or 'informal economy' is here defined as trade, services or production, that is non-compliant in any aspect(s) of company registration, tax declaration/payment, business regulation (eg. employer's national insurance, public/employer's liability insurance), and/or licencing requirements for the specific trade (eg. health and safety certificate, driving instructor's licence, publican's licence). It does not include either 'self-provisioning' (eg. doing one's own cleaning, plumbing, car repairs), or illegal 'black economy' activities (eg. drugs, child labour, money laundering).

# Chapter 1

## Micro-entrepreneurs in the UK
## Lessons about the client market

**Street UK’s understanding of the UK micro-entrepreneur community is described in the context of three different perspectives:**

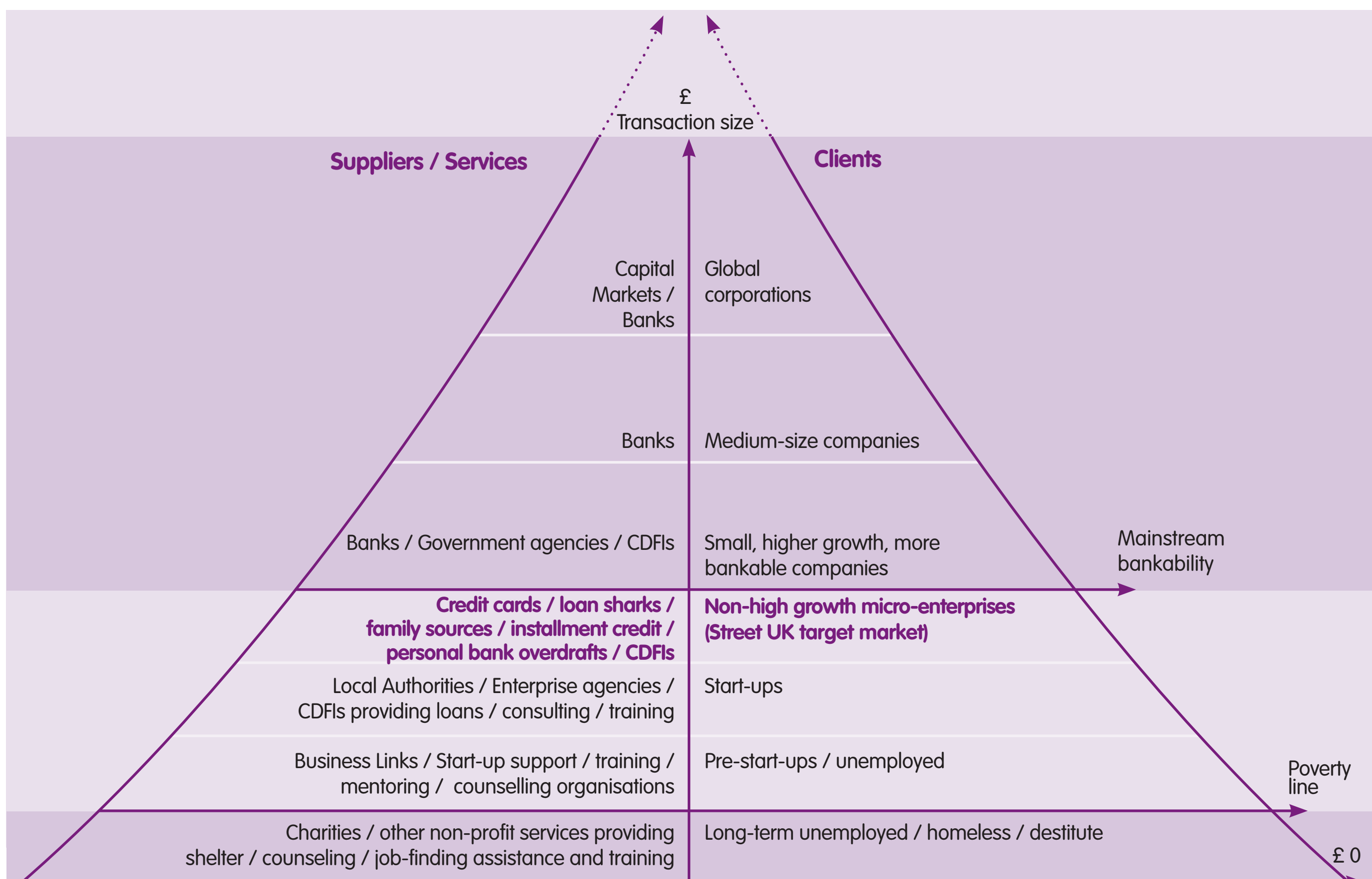
- Accessing suitable business finance
- Graduating an informal cash-based activity into a fully regulated small business (illustrated with a case study of Michael); and
- Being assisted appropriately out of different types of poverty or disadvantage.

**From these perspectives, the nature of micro-entrepreneurs’ financial and business support product requirements is then addressed.**

Whereas the micro-finance industry has largely been driven by a poverty alleviation agenda in developing countries and by an enterprise development agenda in the post-command economy transition countries of Eastern Europe, in industrialised countries micro-finance has been primarily introduced as a tool to combat the social and financial exclusion of a segment of society that lies *between the poor and non-poor:* i.e. a population group that falls below the radar screens of mainstream financial institutions, but above the upper limits of most forms of charitable/state support. This is shown in the diagram below.

## UK Micro-entrepreneurs in context

### Market segmentation of suppliers of finance and their clients




The population segment marked in bold numbers several million people in the UK (11) and comprises two main sub-groups:

> People living off some state benefits supplemented by informal income-generating activities;

> People living solely off their own business income but not declaring either some or any of this income for tax purposes.

These are shown as groups 3 and 4 within the 'Spectrum of micro-entrepreneurs' given on the next page and account for about 80%-90% of Street UK's clients, the other 10%-20% comprising groups 2 and 5.

(11) Amongst legally registered businesses, the Dti estimates that 2.5 million of the total 3.7 million businesses in the UK employ no more than 5 people. A large proportion of these are unlikely to be able to obtain business loans from mainstream sources. Amongst unregistered businesses, Provident Financial, the UK's largest money lender with 2 million clients in 1998, estimated that about 25% of them were borrowing (on a consumer loan basis) for income-generating activities. If one assumes the same ratio for the clients of the other major money lenders, there could be up to 1 million total unregistered businesses borrowing from money lenders, in addition to all the unregistered businesses which are not borrowing from them.

## Spectrum of micro-entrepreneurs within the context of the informal economy

**1. People in receipt of Jobseekers Allowance, other state benefits and supplementary earned income within the legal maximum.**

**2. People in receipt of Jobseekers Allowance, other state benefits and supplementary earned income, exceeding the legal maximum (for them to legitimately claim the benefits).**

**3. People not on Jobseekers Allowance but in receipt of other state benefits and earned income which may be wholly or partly undeclared.**

**4. People not in receipt of any state benefits but not declaring any or part of their earned income and/or not meeting any/all other regulatory requirements.**

**5. People declaring all of their income and meeting all other regulatory requirements, but still not able to access mainstream financial services for their business.**

**6. Fully bankable small businesses.**

By trying to advance in life beyond benefits dependency and become fully regulated small businesses, many of these people become branded ‘benefits cheats’ or ‘tax dodgers’. However, the reality is that the majority would like to operate in the formal economy, but find the obstacles to doing so insurmountable.

## Welfare-to-regulated small business transition: Understanding the obstacles - The case of Michael

Michael arrived from Jamaica 15 years ago and, despite operating a joinery business, is officially unemployed. He specialises in making and/or fitting new counters/ shelves and lighting, as well as decorating small high street shops. Michael works for cash; all of his work comes through word of mouth. Michael has never registered for self-employment. The quality of his work is excellent and, because he charges cash prices, he has no shortage of clients. Over the last 10 years, he has managed to save £15,000.

Knowing just how much business he can undertake in a month and stay 'invisible', the amount of new business Michael delays or turns down is at least twice the amount he accepts. As he is on disability benefit (for asthma), he manages the five school-leavers he has working for him but does not do any of the work himself. Some of his 'employees' are on benefits – the cash wage he pays them is therefore supplementary and probably illegal income.

Michael has decided to 'give himself up' and seek help to 'go legit'. Although his fear of losing the financial security offered by his benefits and cash-in-hand work has kept him underground all these years, he realises how much more he could achieve if he did not have to deliberately cap his income. He is under pressure from his wife who can not sleep properly for fear of tax inspectors knocking at the door. But, most of all, he would like to give his children a better start in life than he had himself.

The costs of formalising Michael's business and making it bankable include:

1. Public liability and employer liability insurance.

2. Extra 'in-transit' household contents insurance to cover his joinery tools while out on a job.

3. Employer's national insurance contributions.

4. Higher wages – he can no longer employ people on benefits who only need a supplementary income.

5. Loss of benefits – both Michael's income and savings exceed the permitted thresholds.

6. VAT – Michael's gross revenue is well above the threshold

7. Income tax.

8. Bank charges (from the use of a bank account instead of a 'mattress').

9. Bookkeeping costs.

10. Marketing costs to try to attract a new, upper level client base, due to having to charge much higher prices to cover the legitimisation costs.

Had Michael been in another trade such as childcare or catering, where operators' licences and premises which complied with Health & Safety regulators had to be obtained, he would also have had to incur the expense of:

11. A major investment in his home, or

12. The rental of suitably equipped business premises.

The average gross margin increase necessary to give Michael the same net cashflow, is about 350%. This means increasing his charges from £10 to £35 per hour, excluding the benefit of any tax deductions to which he is entitled. Deductions can be made for:

13. A portion of his utility bills.

14. An allocation of home premises costs.

15. Any (consumer) borrowing costs for his business.

16. Pension fund contribution.

Nevertheless, the total net legitimisation costs are still substantial. Perhaps the biggest challenge of all is how to develop an entirely new client base, willing to pay fully-loaded prices. In the face of stiff competition from other cash entrepreneurs, there is very little likelihood of Michael keeping his current clients.

A customer paying higher prices will certainly expect a higher quality product or service. This is beyond the capabilities of many micro-entrepreneurs. On the other hand, given their work ethic and the pride they take in not being unemployment benefit 'spongers', closing their business and reverting to benefits would be completely humiliating, as it would mean shifting from being an active, working citizen to being a passive benefits recipient. Self-employment is often either the only option or the least objectionable or financially insecure option available to the majority. If they have to close their business because it cannot survive on a fully regulated, tax-paying basis, the prospect of their finding suitable employment is very unlikely.

Street UK has learned that, in comparison with micro-entrepreneurs in countries where micro-finance thrives, micro-entrepreneurs in the UK face the following specific challenges:

> A highly competitive and developed private sector, making the ongoing chances of survival of a small business much lower than in developing countries. (In 1997, Dti figures showed 500,000 new businesses started-up in the UK, whilst 480,000 businesses went bankrupt) (12).

> The poor design of the welfare system, specifically: (a) disincentives for people to graduate off welfare into self-employment, because benefits terminate before the business has generated a sufficient income to manage without them; and (b) the manner in which the benefits are paid, frequently by-passing the beneficiary and going straight to the service provider (e.g. to the landlord in the case of housing benefit), thus creating a serious financial illiteracy problem because people are no longer in full control of their household budgets. This results in a lack of skills to undertake basic cashflow management and keep proper records.

> The easy availability of consumer finance often at very high interest rates (150-500% APR) from legal money-lenders, and of consumer goods for purchase on a zero deposit installment payment basis. This has both exacerbated the financial illiteracy problem and created a mass over-indebtedness culture (aggravated by legal predatory lending practices) in which savings are no longer considered necessary.

> A high level of legal and regulatory requirements for small businesses. This 'red tape' is at least as big a problem as the financial disincentives.

> A minimum wage plus employer's national insurance which is significantly higher than the informal market rate for typical labour requirements.

> The deterioration of traditional social bonds, particularly the mutual support links between family members, reducing the risk protection and insulation against problems for any single individual.

These issues can be further understood within the poverty framework set out by Monique Cohen (13). In particular, she has shown that people have a pyramid structure of needs, with psychological needs at the base and financial needs at the top.

## Pyramid structure of needs (14)

**Psychological:**
**Meaning levels of self-esteem and self-confidence, which are the basic requirements for people to believe that it is worth trying to better themselves.**

**Social:**
**Meaning the support provided by family, friends and anybody else that they can turn to in times of trouble. The number and quality of these relationships are crucial in helping them to cope in fragile times.**

**Physical:**
**Encompassing any assets that are basic requirements for them to have a reasonable life with a minimum level of personal dignity. In developing countries, it could just be food or a roof over one's head. In the industrialised world, it probably includes a telephone and television, as well as basic education / skills because, without these, people are unable to participate in the 'knowledge economy' and many aspects of mainstream life.**

**Financial:**
**Measuring capital, financial assets or savings, as well as income. The capital element is particularly important because, in looking at ways in which people tend to succeed in rising out of poverty, building a capital base appears to be a crucial part of the process, i.e. an income-building only approach is insufficient** (15).

(12) No aggregated data has been published by the Dti since then.
(13) Jennefer Sebstad and Monique Cohen, "Micro-finance, Risk Management and Poverty", CGAP, Washington DC, 2001
(14) The term 'needs' should be understood here as requirements for a customer service and not as any reflection of dependency on aid from benefactors. Micro-entrepreneurs generally are a highly resourceful, independent, self-supporting population group, who regard themselves as (and indeed are) paying customers of the services they buy.
(15) In particular, Cohen's findings show that when people experience difficulties or set-backs, they tend to first seek family support, then sell an asset or deplete their savings, and only take out a loan as a last resort.

Despite the abject levels of income in developing countries, micro-entrepreneurs suffer *relatively* less from lack of personal self-esteem and confidence (because their situation is the norm, rather than the exception, within their society) and also have much stronger social networks of community and family support. One of the biggest missing links for them, therefore, is loan capital and financial services.

In comparison, micro-entrepreneurs in industrialised countries, being an 'invisible' minority, are truly socially excluded as well as individually isolated from traditional extended family support. The role of community organisations in re-building these and reinforcing them with institutional support is therefore not only critical in its own right, but also a pre-requisite to the creation of sustainable financial services for this market.

Street UK believes that this difference perhaps explains one of the main reasons that micro-finance programmes in developing countries can successfully lend to large numbers of borrowers without additional social or skill-building support, whereas this is not the case in industrialised countries such as the UK (16).

## Appropriate services to address each need or requirement

The first level of services  believes are needed are various types of personal and community building support services, typically provided by local community-building organisations. These help *build people's individual self-esteem, courage and confidence, and strengthen the bonds of mutual support within their communities.*

The next level of needed services are those that start to create *financial literacy, business knowledge and the skills to be better equipped to enter into employment or self-employment.* Financial education for personal household budgeting and/or business finance, and business knowledge become essential services in this category.

The third tier of services which start to become relevant once the first two have been provided, are a range of *tailored financial services including savings, insurance and loans.*

The diagram below gives an idea of how the pyramid of micro-entrepreneurs' requirements have been met in East London. In particular,  has seen how essential it is for organisations only providing financial services to embed their work within those of community organisations.

### Micro-entrepreneur needs and provision in East London

| Elements of poverty | Psychological | Social | Physical | Financial |
|---|---|---|---|---|
| Examples of each | Low self-esteem<br>Low self-confidence | Isolation<br>Lack of support group | Lack of basic skills, goods or services | No savings<br>Low Income |
| Support services required | Personal and individual skill development | Community building and promotion of mutual support | Education and skill-building tools,e.g. financial literacy, life planning, business skills | Tailored financial services with outreach support, at affordable cost |
| Examples of East London providers | Prevista<br>Community Links<br>Bromley-by-Bow Centre<br>-<br>-<br>-<br>-<br>-<br>- | Prevista<br>Community Links<br>Bromley-by-Bow Centre<br>Bootstrap Enterprises<br>Prince's Trust<br>East London Micro-credit Consortium<br>-<br>-<br>- | -<br>Community Links<br>Bromley-by-Bow Centre<br>Bootstrap Enterprises<br>Prince's Trust<br>East London Micro-credit Consortium<br>Street UK<br>Hackney Business Ventures<br>- | -<br>-<br>-<br>Bootstrap Enterprises<br>Prince's Trust<br>East London Micro-credit Consortium<br>Street UK<br>Hackney Business Ventures<br>East London Small Business Centre |

(16) Other factors which have also reduced the number of borrowing clients for micro-finance organisations in industrialised countries include the much greater supply of capital from alternative financial and non-financial intermediaries.

## Prioritisation of financial objectives

> Within the financial services element of support, the first priority to help micro-entrepreneurs is to *reduce the volatility of their income:* that is, to put a 'floor' of 'safety net measures' under the worst case situation that they could find themselves in, so that their efforts to rise out of poverty cannot leave them worse off (and particularly subject to a sudden drop in income, where there can be real suffering).

> The second financial priority is to help people to *build a nest egg of savings* which will provide the backstop against which they can try to improve their lives. This is particularly important because they may not have the courage to, or it would be imprudent for them to, take risks to improve their life if, in the worst case, they could not continue to support their family. A backstop 'Plan B' reserve fund is therefore critical to encourage people to make the attempt.

> The third financial priority is to *raise their average income levels*, which can be achieved by the use of loans, to leverage up their capital. With the achievement of this goal, there is often an increase in their standard of living. While on the one hand, this is highly desirable, on the other hand, it raises the platform from which they may fall if things go wrong. This is why, in Street UK's opinion increasing a person's average income becomes the third, not the first, goal, and loans for this purpose become the third, not the first, support tool (17).

Finally,  has also found that a significant proportion of its clients often act as social entrepreneurs within their communities, by subsidising or supporting more disadvantaged people who may be their customers, employees or even purchasers of their business assets. This is their way of contributing, which on the one hand is proof of their generosity, and on the other is disadvantaging their business's creditworthiness, and therefore needs to be costed and recognised separately as an activity potentially worthy of external support, so that the underlying profitability of their business becomes more transparent (18).

| Priority | Financial priorities for transition out of poverty | Financial products to address each priority |
|---|---|---|
| 1 | Reduce risks, i.e. income volatility,<br>Secure acceptable worst case living standard | Tailored insurance products, e.g. affordable public and employer liability insurance, long-term disability, etc.<br>Dedicated savings funds for risk protection<br>Very short-term loans |
| 2 | Build nest egg / rainy day fund to protect against problems | Financial planning tools. |
| 3 | Increase income leavels | Tailored savings products, including matched savings programmes.<br>Short and long-term loans, leases and barter schemes |

(17) Where loans are used to cover short-term cashflow interruptions, they may still be a top priority support tool.
(18) Putting aside the legal and regulatory compliance aspects, this appears to be one of the most effective and cost-efficient methods of supporting a population group that public and voluntary sector institutions find very hard to reach.

# Key lessons about micro-entrepreneurs

> In summary, micro-entrepreneurs in the UK need support beyond the level in which they are considered by charities and policy-makers to be ‘in need’, all the way through the grey market transition process that gives them access to mainstream financial and business support services.

> They need a range of financial services, not just loans, to achieve a number of objectives, including: insurance to reduce risks; and savings to build assets, which are key to long term, secure improvements in their lives and their businesses.

> Loans are a critical element for those micro-entrepreneurs who do not first need other more basic forms of support and for those who have already been provided with other support mechanisms.

> A raft of non-financial business support services are needed to complement the loan capital to help micro-entrepreneurs become fully regulated small businesses, including specific help to enable them to transition out of the grey market.

> Micro-entrepreneurs and social entrepreneurs are not two discrete markets. Many are a mix of the two. For this reason, separate grants are needed to support the social enterprise or community development element of micro-entrepreneurs’ activities.

# Chapter 2

## Financial services required by micro-entrepreneurs

## Lessons about the required products and services

The three main categories of financial services required by micro-entrepreneurs, namely: insurance, savings and loans, are identified, together with the specific features of each which Street UK has found to be either unavailable or unaffordable from mainstream sources, but which are greatly needed by this market. The case study of Beverly is also provided to illustrate the need for tailored loan products.

Based on the understanding of micro-entrepreneurs' requirements for financial services outlined in Chapter 1, Street UK has identified the following elements of insurance, savings and loan product design, where there are currently gaps in the market.

## Insurance

In general, there is a major problem of risk exposure for an already vulnerable population group least able to afford the consequences. In particular:

### Public liability cover

A self-employed person who mends roofs, for example, may have to pay £1,500 a year premium if he operates above 10 feet high – which is nearly every roofer's situation – just to cover himself in case his ladder falls on passers-by and injures them. This kind of public liability insurance is a legal requirement for all businesses, and yet £1,500 is beyond a typical micro-entrepreneurs' capacity to pay. As a result, they rarely insure themselves, remain hugely vulnerable and, because their work is now illegal, remain in the shadow economy.

### Contents insurance – 'in transit' cover

A self-employed micro-entrepreneur based from home may be able to get affordable contents insurance (depending on their residential postcode) but they can rarely get 'in-transit' insurance. This means that if they put their tools and equipment in their van and leave them there (while they are working at a nearby premises), and then the tools are stolen, they are not covered and so lose their key business assets. This may even stop them from being able to generate any income, leading to the liquidation of their business.

### Long term disability insurance

Perhaps the single most important risk that a self-employed person needs to cover is the risk of long term disability. This is because if they have an accident and cannot earn an income for the rest of their working life, there is no backstop income substitution coverage for them, nor any retirement pension. Unfortunately, no affordable insurance presently exists to protect against this risk.

Street UK intends to seek partnership arrangements with mainstream insurance companies in order to jointly develop products tailored to its market (and then become an agent to market them). Where the risk category is disaggregated, i.e. affects micro-entrepreneurs *independently*, it may also be possible for Street UK to play an intermediary role between the client and the insurance company, whereby clients' premiums can be offset against each other and thus reduced, because the insurance company is provided with a diversified portfolio of risks.

## Savings

The importance of building a reserve/savings fund is based on the following assumptions (19):

> The restoration of a culture of savings, particularly amongst poor people, is a key method of reducing their exposure to risk and helping them to build-up some capital.

> Asset-building is a far more powerful root out of poverty than income-building, as it gives people the fallback cushion they need to take risks, which in turn are usually necessary to reap rewards.

> A root problem is with inadequate education in basic money management / household budgeting and in short, medium and long term financial planning. On the other hand, when 'financial literacy' schemes have been offered on an optional basis, there is a mediocre take-up rate at best (20). Street UK believes this is due to insufficient connection being made between the education and the precise difference it will make to savers' lives, particularly in the short term.

Building savings is not an easy task, however, as it involves people having to run counter to a widespread culture of debt. If they are to refrain from purchasing all their goods with the credit made available to them, they will need high levels of self-discipline.
For the majority, some significant financial incentives will be required.

(19) Street UK, together with Community Links and the SAFE programme at Toynbee Hall believe these assumptions to be valid and have therefore sought to run an extension of the government's Savings Gateway ('SG') pilot to test the feasibility of the savings product parameters described in this chapter. In particular, they would like to advance one level beyond the main objective of the current SG programme, which is to encourage people into the habit of saving or to save more than they have before. The next level of objective is to help people to build up their capital through savings as a key route out of poverty, based on the evidence of the validity of this approach in the USA. Both objectives are important but the government has yet to accept the validity of asset-building as a poverty alleviation tool.
(20) The experience of the SAFE programme at Toynbee Hall, when conducting one of the Savings Gateway pilots, has been that few people elected to receive financial literacy training when it was offered on an optional basis. A full evaluation of the Savings Gateway pilots by the Personal Finance Research Centre at Bristol University is currently underway and due to be published in Spring 2005.

### Structured financial planning

Some of these incentives might include a simple but structured financial planning session, that helps people to think about their personal goals, business goals and their financial aspirations; costs each one out and gives them a timetable and priority ranking; then considers the maximum possible level of regular savings; and concludes with a savings plan for one or more specific purposes (including debtrepayment, where applicable) that would be closely tied to their top priority goals. Without this clear picture of how the hard next few years of their life in putting the funds aside will truly benefit themselves or their families, it is much less likely that they will stay the course.

### Matched funding

Secondly, some matched funding is likely to be needed for a defined period to help motivate people to put aside significant amounts. Specifically, because the market is complex, and a one-size-fits-all solution is inadequate, Street UK believes a multi-option product is needed, which allows people to choose whichever option is the most appropriate for them, the key variables within each option being:

> The eligibility criteria for the participant.

> The maximum amounts that will be matched.

> The savings match ratio.

> The degree of restriction on the purpose of the savings.

> The timing of the payment of the match funds.

> The degree of flexibility on emergency with-drawals, missing the savings targets from time to time, etc.

The option with the most restrictive eligibility criteria (ie. for the poorest people) would have the lowest cap on amounts that would be matched and the lowest savings match ratio. On the other hand, they would also have the lowest restriction on the purpose of the savings; the most flexibility on savings patterns (i.e. missed months) and withdrawals; and the soonest payment of the match money into the client's account. There would then be a graduated reversal of these restrictions, flexibilities, amounts and timing, to the other end of the spectrum of options, where savings would be restricted to vocational education, micro-enterprise development, property purchase and other income-generating or asset-appreciating purposes, but offer the highest match amounts and ratios.

### Savings discipline support

The third desirable element in the design of an appropriate savings product is some optional savings discipline support. This could constitute a variety of alternative peer group mutual support measures to help keep savers on track, in similar ways to Alcoholics Anonymous or Weight Watchers. These could include both sticks and carrots, eg. joint bank account signatory arrangements to discourage easy withdrawal, fixed time deposits with heavy penalties for early termination, bonuses for saving a minimum amount and/or an escalating match rate with every additional deposit.

## Loans

In relation to debt, Street UK's understanding of the market of current suppliers is that it is complex, with both helpful and unhelpful elements contained within a single product or service. For example, with regard to the current practices of (legal) money lenders which, in the UK, together have well over 3 million customers (21), the following elements can be seen:

### Packaging

The sheer number of money lender clients provides important evidence that their marketing approach and packaging of personal loans is extremely well tailored to their clients' needs. It includes home visiting, collecting the money from the borrowers immediately after they receive their welfare or salary cheque (when they are most able to pay) and friendly staff employed from within the client community, who understand their circumstances. The CDFI sector has a lot to learn from the commercial sector in terms of the way such products need to be presented and marketed in order to attract a high volume of clients.

(21) See footnote (11) for the basis of estimating the market size.

### Interest rates

Typical interest rates charged by UK money lenders range from 50% p.a. to 1500% p.a. with most people paying somewhere between 150% p.a. to 800% p.a. In the developing world, it has been found that micro-entrepreneurs care more about permanent access to capital, than price (ie. high interest rates, provided interest rates are reasonable in proportion to the loan size). Clearly, UK money lender interest rates are not reasonable in proportion to the loan size, because they can easily lead to an obligation of several multiples of the original sum borrowed. This has caused countless tragic consequences for the borrowers (22).

Street UK charges between 12% and 26% p.a. on its loans and is considered inexpensive by the vast majority of its clients, not only in comparison with money lender rates, but also with family sources. For example, Street UK has learned from some of its clients that, in the Indian community, first cousins charge about 50% p.a. interest to each other. With Street UK's own loans, £2,000 borrowed over a one year period at 25% APR, will cost the borrower about £5 per week, which is on average only 5-10% of the projected incremental net income from the use of the loan proceeds during the period of the loan. Therefore, while interest rates cannot be extortionate, they can be priced to cover at least the marginal cost of lending (23).

### Loan amount

In terms of setting the correct loan amount, loan purpose and weekly/monthly repayment levels, this is where the biggest problems have been observed with current money lenders' practices. In terms of loan amount, in order to help people out of poverty, the *amount of debt* they take on has to be *minimised in relation to the income they can generate* from the use of the loan proceeds. As a lender, that philosophy runs contrary to the idea of maximising sales. To optimise the return on the cost of debt for a borrower, they need advice on how to reduce their loan requirements to the minimum while still achieving their objectives, as well as to consider how they can direct their loan proceeds into the highest revenue-generating purposes possible.

### Loan purpose

With a typical client, their request for a £10,000 loan to pay for a new van has been converted into a £2,100 loan, £2,000 for a second hand van and an extra £100 to get the van sign-written, so that the client's phone number is permanently advertised on it. This is clearly far less remunerative for Street UK but is essential to help the client's business to survive, let alone progress. In the box to the right an example is given of the typical (inappropriate) finance offered to micro-entrepreneurs, this time from a bank.

## Key lessons

> Community loan funds, including micro-finance organisations, should be learning from commercial lenders, and particularly money lenders, in terms of their product marketing and packaging.

> They should be charging interest rates that are neither extortionate nor below the cost of capital plus marginal cost of lending.

> They should be absolutely refuting the worst of predatory lending practices such as the constant capitalising of interest and unlimited escalation of the principal amount owed.

> They should also be much more pro-active in helping clients think through the purpose of the loan to optimise their return on the cost of borrowing, and structure their repayments to their current (not future projected) cashflow.

(22) See: Palmer, H. and Conaty P., "Profiting from Poverty: Why debt is big business in Britain", a NEF Pocketbook, pub. 2002

(23) In developing countries, micro-finance organisations aim to charge interest rates which are sufficient to cover the full cost of lending and give them a surplus or profit, after taking into account even the imputed commercial cost of their capital (assuming that it is actually subsidised). This can result in interest rates of 20-60% p.a. In industrialized countries, by contrast, a combination of factors discussed in Chapter 1 make much lower interest rates necessary. Nevertheless, it should always be possible to charge a rate which covers the marginal cost of lending, ie. the direct cost of capital and loan loss provision. In more mature programmes, eg. in the USA, the loan interest and fee income has also covered up to 50% of the lending organisation's total overhead costs.

## The dangers of inappropriate lending - The case of Beverly

Beverly, a mother of three children, living in East London, was married to a well paid accountant. She and her husband had a joint bank account with one of the mainstream banks. Her husband subsequently left her (for another woman), leaving her with no income other than state benefits, which were insufficient to pay the bills. In order to supplement her income, she bought a word processor and started typing for people that she knew. Her friends were good about giving her work to do and she worked regularly until midnight. However, precisely because they were her friends, she was embarrassed to chase them for payment when they did not pay regularly or on time.

In order to fund the cashflow gap, she worked harder still, sometimes only catching a few hours sleep per night. When it became impossible to carry on this way, she went to her local bank branch and asked for an overdraft. Because the bank did not know that her husband was no longer supporting her, it offered her a percentage of the average balance for the last 3 years on the joint bank account, which was quite healthy for the majority of the period. She then used the overdraft proceeds to pay her household bills and the interest on the debt. At the end of a year, when the bank required full repayment of the facility, she was unable to repay more than half of the amount owed and ended up bankrupt.

How could a lender have provided a more appropriate response? A micro-finance organisation such as Street UK would have tried to tackle the root causes of Beverly's problem by suggesting that she recruit a part-time person to collect the cash off her clients and use the loan to pay for that person's first couple of months' wages, before their work then paid for itself (several times over). There would then have been a review of exactly how much she needed in relation to her cashflow capacity, in order to determine both the correct loan amount and repayment schedule.

It is easy to see why neither banks nor money lenders operate in this way. The expense of the 'appropriate response' involves building a complete, detailed cashflow statement from scratch, after talking with the borrower for at least two hours and visiting her home, in order to understand her total financial situation. Nothing less than this level of support, however, is likely to have really helped Beverly.

# Chapter 3

## Street UK's loan and business support product
## Lessons from providing loans, advice and support

The current terms and conditions of Street UK's loan and business support product are described, together with its internal business/credit analysis process, which it has developed after an extensive pilot testing programme.

The key lessons are then summarised from Street UK's experience of both lending and providing business advice and support.

This is followed by a table which provides further detail regarding the results of all the variables it has tested.

# Current product and service offered

After three years of operations, Street UK has developed its client services into the current form:

**Loans** for business development structured individually to the borrower's cashflow, with further, incremental loans available until the borrower either no longer wants to borrow or chooses to switch to a mainstream bank.

**Advice** based on the construction of a detailed diagnostic analysis of the business, which serves both as a client training and advisory tool and as a loan assessment form. (See the table at the bottom of the page).

**Support** which consists of ongoing help from its front-line staff, geared toward providing the client with a friendly 'financial partner' relationship.

Street UK's current loan terms, rates charged and approved purposes are shown in the tables below.

| Loan terms and conditions | Flexibilities in loan terms |
|---|---|
| Micro-enterprise trading for at least 6 months | No legal / tax status requirements |
| Maximum 5 employees | No business plan required |
| Looking for maximum £10k loan amount (24) | No set documentation requirements |
| Lives/works within 20 mile radius of Street UK branch | County court judgments do not disqualify applicant |
| Can provide a guarantor or fixed asset as security | No age, gender, race restrictions |

| Loan amount | Loan period | Interest rate charged (APR) |
|---|---|---|
| £2,000 | 12 months | 26.8% |
| £5,000 | 24 months | 22.0% |
| £10,000 | 36 months | 17.2% |
| £15,000 | 60 months | 12.4% |
| £20,000 | 60 months | 12.4% |

| Approved Street UK loan purposes | | | |
|---|---|---|---|
| Stock purchases | Upgrade of equipment | Refurbishment of premises | New product development |
| Replacement of equipment | Purchase of equipment | Expansion of current business | New business development |

NB. All loans are available for retail, services or production businesses

As regards the business advice and support element of its service, the table below shows the main headings of the diagnostic tool which Street UK has developed specifically for micro-entrepreneurs with minimal records (and uses for both client advice/ training and internal credit assessment purposes).

| Background | Business strategy | Business financials | Total cashflow | Due diligence | Advice/Support |
|---|---|---|---|---|---|
| Key track record/ data quality indicators | Market positioning of business<br>Customer analysis<br>Suppliers<br>Equipment<br>Licences / permits / insurance | Business profitability<br>Business assets & liabilities<br>Current project description | Household expenses<br>Secondary sources of household income<br>Personal assets & liabilities<br>Comments on cashflow calculation<br>Summary financial ratios | Bank accounts, credit cards, credit history<br>Summary reference & guarantor information<br>Due diligence undertaken | Business advice, introductions and support provided |

(24) Maximum for first time borrower only. For repeat borrowers, the maximum is determined by their individual cashflow capacity. The current average loan size for a first time borrower is £2,000.

These terms, conditions, processes and support tools have resulted from a systematic programme of piloting and refining each individual element. More detail about the precise variables tested and the results of each test is given in the table at the end of this chapter. A selection of the more noteworthy lessons are also highlighted below.

## Key lessons from lending

### Loan size

People tend to wish to borrow 3 times as much as their cashflow permits. A £10k maximum offer therefore tends to produce £3k borrowers.

### Lending model

Group loans with mutual guarantees tend to be taken by borrowers in the same type of trade or subject to the same risks. They therefore do not provide suitable security as one borrower's problem is likely to be shared by the others.

### Product packaging

In order to appeal to a larger market, micro-loans need to be much more attractively packaged and designed to clients' convenience, incorporating key lessons from the commercial money lenders. Loans which are only appropriately structured and priced are unlikely to have widespread appeal as some elements of the structuring process are more demanding on clients' time or require too much self-discipline / sacrifice relative to the commercial alternatives.

### Security

More guarantors decrease the feeling of responsibility by each one. One guarantor therefore provides better security than several. Although guarantors do not tend to voluntarily make repayments for the borrower, they do help by putting more effective pressure on the borrower to pay, particularly if they do not have County Court Judgements (CCJs) themselves. ie. their motivation is to avoid a court record. They also provide some repayment security if a court process is followed.

### Credit policy

Borrowers need a much bigger cashflow cushion than anticipated, to cover high volatility, partly caused by poor financial management. Credit checks on both the borrower and guarantor are very useful, providing valuable information at minimal cost.

### Reference-taking

Street UK conducts a 'low level' credit check which costs £1.77 per client and find it invaluable as it (a) confirms the borrower's address; (b) whether he/ she is on the voter's roll; (c) other potential lenders' checks; (d) CCJs and e) related CCJs, eg. for family or household member.

### Advice and support

Street UK has found a minimum level of advice and support to be a necessary ancillary service to its loan product. The key principles of this advice and support, which it has developed specifically for micro-entrepreneurs who are not culturally attuned to developing formal business plans, but do have the 'street' skills to be successful, are given below.

## Key principles of advice and support

### Customer / revenue- (vs. investment-) led business development

This comprises intensive focus on attracting new clients (rather than purchasing expensive equipment with high profit potential).

### Return on capital optimisation

This is the corollary of the above principle, i.e. that whether the business's capital comes from the owner's savings or from borrowed funds, the return on its use needs to be maximised (25).

### Development via many smaller (vs. fewer, larger) incremental steps

The main objective is to help clients take the largest step they can, with a 90% or greater chance of success, so that even if these steps are very small, each one builds a firm foundation of growth

(25) See Chapter 2: Loan Purposes and the boxed case of Beverly for examples of how Street UK achieves this.

from which they can progress further. Street UK's experience is that its clients' self-confidence and performance are hugely dependent on their efforts succeeding. This is the reason that it attaches so much importance to making each step manageable.

### Emphasis on self-help (vs. mentor assistance)

Once each step is reduced to a manageable level, the client will be less dependent on a mentor. Achieving each step without assistance can be a prerequisite to further reinforcing their self-confidence and enthusiasm to go one step further.

### Focus on cashflow (vs. profitability or net assets)

Whilst businesses are micro in scale, cashflow is the single most crucial determinant of its survival. Street UK's experience is that profitability and net assets do not start to become as important as cashflow until it is lending at least £7,000 - £8,000 to a client.

### Recognition of subsidies (e.g. from family support / home premises)

Many clients do not realise that their businesses are unprofitable when all their costs (as opposed to their marginal costs only) are included in the calculation. This recognition of the subsidies that the business is receiving is the first step in helping them to consider how to improve its viability. Typical examples include the use of home premises, 'free' family labour or a friend's vehicle.

### Risk identification and mitigation

In keeping with Street UK's overall objective to put a floor under the worst case scenario for its clients in order that this should provide a firm base for progression, it puts considerable attention on identifying the greatest areas of risk exposure for each client and considering ways in which these can be reduced. (This is consistent with its role as a lender (26).

## Transition into a fully-regulated, tax-paying business

**Street UK measures the impact of its clients' progression in the following areas:**

- Moving from part-time to full-time work
- Moving from home to business premises
- Keeping basic level records
- Keeping higher level accounts
- Purchasing public liability and employers liability insurance
- Hiring employees on a PAYE basis
- Using a bank account for business transactions and/or opening a separate business bank account
- Obtaining the required licences and permits to operate, e.g. Health and Safety certificate or driving instructor licence
- Graduating off all non-work state benefits
- Graduating from majority cash revenues to majority invoiced revenues
- Incurring a formal business tax liability
- Becoming VAT registered

Given the costs involved in making the transition in many of the above areas, Street UK does not expect its clients to cross more than 2–3 of these thresholds within a 12 month period. Its advice is, therefore, very much common-sense based, with issues of physical danger and consumer protection considered together with the legal consequences of non-compliance and the financial costs and benefits of compliance, in recommending which issues should be considered a priority by each client.

(26) Street UK does not engage in new business development advice, eg. to switch from running a green grocery to a pizza parlour, as this would be in conflict with its role as a lender.

# Loan product variables tested

| Variables tested | Successful tests | Rejected tests | Comments |
|---|---|---|---|
| **Loan terms** | | | |
| Maximum 1st loan size | £10,000 | £3,000 | People tend to wish to borrow 3 times as much as their cashflow permits.<br>A £10k maximum offer therefore tends to produce £3k borrowers. |
| Maximum repeat loan size | No cap | 50% increase on previous loan | Repeat loan amounts are determined by the borrower's cashflow capacity. |
| Maximum 1st loan term | 12 months | | A short 1st loan enables limited risk-taking on new clients |
| Maximum repeat loan term | 60 months | 12 months | Repeat loans can be double the term of the borrower's Street UK credit history. |
| Lending model | Individual loans | Group loans | Group loans with mutual guarantees tended to be taken by borrowers in the same type of trade or subject to the same risks. They therefore did not provide suitable security as 1 borrower's problem affected all the others. |
| Security accepted | 1 personal guarantor; Business assets as alternative security | 3 personal guarantors | More guarantors decreased the feeling of responsibility by each one. Business assets are only a viable alternative for larger loans, selected assets and specific legal structures (eg lease). |
| Interest rate structure/ fees | 12.4% p.a. - 26.8% p.a. + no fee, sliding scale decreasing for larger loan amounts and longer terms. | 16% p.a. – 25% p.a. + 2% fee, sliding scale decreasing the more borrowers (ie. cheapest rate for 4 person groups). | New pricing structure adapted from commercial lending organisations eg. Tesco Finance. |
| Business support/advice | Systematic but tailored support / advice; Free of charge; Provided in borrower's premises. | Ad-hoc support / advice. | Advice / support Is based on framework contained in credit assessment docs. and covers revenue, cost, risk, cashflow, regulatory and new project issues. |
| **Loan assessment process** | | | |
| Client eligibility | Minimum 6 months trading history; No minimum docs. / records; No minimum legal / reg. status; Positive cashflow. | Minimum 3 months trading history. | 6 months trading minimum reduces applications for re-financing of borrowed start-up capital (vs. leveraging up owner's equity). Owner's character / attitude is much more important than documentation in determining loan repayment. |
| Guarantor eligibility | Satisfactory motivation; Cashflow capacity; Financial independence from borrower; Not dependent on state benefits; Positive Experian credit check also required. | Restrictions found to be unnecessary on: having family members or pensioners as guarantors; Or requiring their geographic proxi-mity to borrower or Street UK branch. | Although guarantors do not tend to repay the borrower's loan when the borrower is unable to, they do put effective pressure on him/her to pay, so long as they do not have CCJs themselves. ie. their motivation is to avoid a court record hence Experian credit check requirement. |
| Cashflow coverage | 25 – 35% target debt service ratio on all loans, with 50% maximum. | Restrictions found to be unnecessary on: having family members or pensioners as guarantors; Or requiring their geographic proxi-mity to borrower or Street UK branch. | Borrowers need a much bigger cashflow cushion than Street UK anticipated, to cover high volatility, partly caused by poor financial management. |
| Legal/regulatory compliance | Minimum attitude towards graduating into a formal business;<br>No minimum compliance level. | 50% maximum debt service ratio on investment loans; 65% maximum debt service ratio on working capital loans. | Minimum attitude constitutes (a) borrower's personal aspirations to formalise; and (b) willingness to listen to/accept Street UK advice / support. |
| Reference-taking | 2 trade references (1 client + 1 supplier) + credit reference with Experian agency (+ reduction in no. of guarantors required). | No minimum attitude towards graduating into a formal business. | Street UK conducts a 'low level' credit check which costs £1.77 per client and finds it invaluable as it (a) confirms the borrower's address; (b) whether he/she is on the voter's roll; (c) other potential lenders' checks; (d) county court judgements (CCJs); and )e) related CCJs, eg for family or household member. |
| Decision-making process | Formal staff credit committee for all loans, with minimum 1 senior manager. | Local staff + credit officer + 1 senior manager; Local staff + credit officer only for < £3,500 loan amounts. | Minimum credit experience needed by at least 1 decision maker is 10 years. |
| Internal credit assessment documentation | Structured Business Analysis form + Cashflow, Profit & Loss account + Balance Sheet. | Freeform text + Cashflow | The current documentation is working well for loans above £1,500. Street UK will next develop a much shorter form for smaller loans. |
| **Marketing** | | | |
| Marketing methods | Formal referrals from community / public sector organisations, banks and bookkeepers; Informal referrals; Newspaper advertising. | Leaflets; Cold calling, Radio adver-tising; TV documentary; Billboards; Commission agreements with trade wholesalers and finance brokers. | Referrals work best because people are pre-disposed to / informed about / more suitable for Street UK service. |

| Variables tested | Successful tests | Rejected tests | Comments |
|---|---|---|---|
| **Marketing brochures** | | | |
| Key words used | "Self-employed people and small business owners"; "Local service"; "No fees / hidden charges"; "Affordable loans". | "Self-employed"; "Micro-business"; "Micro-enterprise"; "Small business"; "Non-profit"; "Not-for-profit"; "Community finance". | |
| Prominently featured | Interest rates charged. | Registered charity status. | |
| Design/look | Commercial style. | Low cost/non-profit style. | |
| Enquires handling | Central (0845) enquiries no. for all branches. | Local branch telephone no.; Local staff mobile telephone no. | The problem with using the local branch / mobile telephone numbers was inadequate staffing availability to take the calls personally. People want to speak to a real person and not leave answer phone messages. |
| **Delinquency management** | | | |
| Loan payment method | Direct debit; Giro card. | Giro book; Cash brought to office. | Direct debit is the cheapest and preferred method, but only works for borrowers with good cashflow management skills. Giro card is next best because it avoids cash and paperwork of giro books. (Clients can make cash payments through the Post Office). |
| Allocation of delinquency management staff roles | Local branch handles process until contact with borrower/ guarantor is no longer possible/ valuable (30-60 days); Back-office handles thereafter. | Local branch handles whole process. | Back-office role includes handling standard delinquency correspondence through to entering cases into court. |
| Rescheduling policy | Rescheduling permitted for (a) liquidated businesses; (b) existing businesses with major drop in cashflow; credit committee decision required for all '(b)' cases. | Credit committee decision for every schedule. | |
| Court process/timetable | Use of debt collection agency instead of court process. | Start court process after 180 days late; Start court process after 45 – 60 days late; Start court process after 60 – 90 days late; Use of solicitors for court process (less effective than Street UK staff). | Street UK has concluded that the court process only works in maybe 3/10 cases, usually where borrowers do not already have CCJs. It has therefore discontinued its use for all other cases. The current use of debt collection agencies instead is a recent development. Still too early to tell how effective it is. |
| **Branch location** | | | |
| Population size | 200,000+ pop. city (Newcastle, Birmingham). | 50,000-100,000 pop town (Bradford). | Smaller towns can be served with one person or part-time staff but in general, a pop. size of 200k+ is needed for a 2-3 person branch. |
| Ethnic/socia-economic composition | Minimum number of existing micro-enterprises; Ethnic minorities; Women. | Extremely deprived areas with few micro-enterprises (Leaside area, London); Bangladeshi women; Indian communities. | Street UK clients include at least a proportionate number of female and ethnic minority people to the pop. as a whole. Exceptions: Bangladeshi women possibly need softer terms and more support; Indian communities prefer to use own sources; no enquiries/requests for Shariah-compliant products from Muslims. |
| Distance from Birmingham/HQ | Close proximity of senior manager to regional manager; Branches in region of company HQ. | Remotely located regional hub; Branches located outside region of Street UK HQ. | Because the regional manager's job is very difficult, it needs close support from his/her line manager. This is not possible with current rail infrastructure unless the distances are small. Difficult to get ongoing RDA funding for local branches of a co. with HQ outside the RDA's region. |
| Number of branches per region | As many as possible, subject to pop. size/demand. | One (Newcastle, Birmingham, London). | |
| **Staff recruitment** | | | |
| Main pre-requisites for region manager | Management / corporate background; Sales experience; Networking skills with referral orgs / funders; [MBA, own business experience helpful but 2nd priority. | Self-employment / own business background. | |
| Salary range for region manager | £30k p.a. + bonus | £25k - £30k p.a. | |
| Main pre-requisites for loan officer | Formal business / education, Work experience (minimum 3 years) and a balanced mix of street skills. | Own business experience with emphasis on street skills. | |
| Salary range for loan officer | £15k - £20k p.a. + bonus | £20k p.a. | |
| Pre-requisites for marketing & credit managers | | 2 – 5 years marketing or credit / risk evaluation experience. | Minimum 10 years credit / 5 years marketing experience needed plus very hands-on approach. These posts have been eliminated as loan portfolio size is too small to justify the cost of people with sufficient experience. |
| Remuneration composition | Bonus system for region manager, Business developers and back-office staff comprising 10% - 20% overall remuneration. | | Bonus criteria mainly tied to loan volume and repayment targets, but also recognise compliance with lending process and teamwork / co-operation. |

# Chapter 4

## Street UK's Organisational development

## Lessons about the business model

**The key elements of Street UK's original business plan are provided. These are followed by a summary of the lessons it has learned in five broad areas:**

> Increasing loan volume
> Controlling loan defaults
> Raising sufficient funding
> Optimising organisational size
> Achieving sustainability

**Alternative strategies for sustainability which Street UK has identified are discussed, before the chapter then shows how these have been incorporated into Street UK's current business plan.**

# Key elements of first business plan

Street UK was launched in September 2000 with a mission of becoming a national provider of business loans to micro-entrepreneurs. The main elements of its first business plan are highlighted below.

### Scale

> 20,000 active clients projected after 7 years from start-up, together borrowing £40 million.

> These would be served through a network of 40 branches throughout the UK.

### Products/ Services

> Individual loans would be offered, but group loans incentivised through cheaper interest rates.

> 20% APR would be charged and the average loan size was expected to be £3,000.

> 3% p.a. long term loan losses projected, net of recoveries.

> The main marketing strategy would be through informal networks, especially client referrals.

> The approach would be 'minimalist', i.e. a simple financial service only, focused on lending.

### Geographic development

> Pilot branch locations would be selected based on their potential to become future regional hubs. Post-pilot branches would then be opened in concentric circles around these hubs.

### Staffing

> The main criteria for recruiting loan officers would be their self-employment / small business experience.

### Finance / funding strategy

> The financial strategy included a front-ended approach to investment and a seven year path to sustainability (27).The front-loading of the investment was intended to minimise the ultimate cost and timetable to sustainability as well as speed up the social and economic impact of the organisation. It was recognised that this would create a higher short-term financial liability.

> The funding was principally expected to come from foundations during the pilot period, and then from national government (to cover the operating deficits) and commercial banks (to on-lend to clients) until breakeven point was reached, after which, only bank financing and equity capital would be needed.

> Institutional investment was sought, meaning unrestricted funds which were not tied to particular geographic areas or target client groups, but linked to Street UK's overall business plan.

Since then, there are a number of lessons that Street UK has learned. These are classified into loan volume, loan repayment, funding, organisational size and sustainability issues.

# Business plan-related lessons learned

## Size of market / loan volume issues

### Financing gap exists

There is indeed a gap in the market for business finance for micro-enterprises. This is demonstrated by the consistent statement from Street UK's clients that it was the only available source of support for them.

### Impact of micro-finance is significant

The loan and business support product that Street UK has developed has had a significant positive impact on the lives of the large majority of its clients, helping them develop their businesses, improve their personal wellbeing, secure and increase their incomes and create additional benefits for their families and communities (28). This is evidenced by client interviews conducted both by Street UK and by independent organisations, such as NEF (29).

(27)See footnote (2) for definition of sustainability.

(28) A typical loan has benefited 8-10 people: the owner of the enterprise, his/her immediate family, the new employees brought in if the business starts to grow, and entrepreneurially-minded people in the local neighbourhood who draw inspiration and confidence from Street UK's client as a role model, in their own aspirations to start a business themselves. (In a random sample of client visits by Street UK staff, about 20% included meeting local people in the clients' premises, who were in the process of receiving support from Street UK's client).

(29) New Economics Foundation ('NEF') conducted an independent evaluation of Street UK on behalf of the Esmee Fairbairn Foundation in Spring 2004. This will result in a public document becoming available in late 2004.

### Market size is much smaller than anticipated

The total market of potential Street UK clients, however, is much smaller than anticipated. This is due to a number of factors:

> There is a major difference between the finance that micro-entrepreneurs need ('appropriate' finance) and the finance they want (i.e. easily available and attractively packaged, but unfortunately unrelated to their capacity to pay and often with very high interest rates). Street UK had assumed that people would want to move away from such finance to the type that responsible lending organisations, such as Street UK provide, but found that there is a general reluctance (or market stickiness) to making this shift, combined with an aversion to a more rigorous credit application process, however much it helps the borrower.

> Many micro-entrepreneurs are already either over-indebted, greatly exposed to risk (through lack of savings or insurance protection) or lack the basic financial literacy, household budgeting or financial planning skills to be creditworthy.

> Others lack key business development skills that equally hinder their suitability to take on a loan obligation, particularly in a mature and competitive market place (whatever their trade or profession) which puts huge pressure on the chances of survival of any micro-enterprise.

> The tax and benefits system either fails to incentivise people who wish to graduate off benefits or cash earnings into formal self-employment, or actively disincentivises them to such an extent that they become trapped under a 'glass ceiling' (30).

> There is a highly developed private financial sector and easy access to consumer credit, reducing the gap between the supply and demand for funds, irrespective of the conditions on which these funds are available.

> Group loans, which were intended to become a key factor in achieving high loan volume, were not possible to make at scale (31). Nor was it possible to offer a 'minimalist' service, ie. a loan product only, because clients also needed considerable business support. This put further pressure on the loan volume, by lowering the staff productivity rates.

These factors have resulted in Street UK substantially reducing its loan projections and revising its business model accordingly.

## Loan repayment issues

### Higher long-term losses than anticipated

Even with extensive micro-lending and commercial lending experience within its management, Street UK has found it very challenging to achieve the high loan repayment rates it anticipated. Specifically, its long term loss expectation is now 8–10% p.a. of its outstanding loan portfolio vs. 3% in its original projection. This is for several reasons:

> The client 'empowerment' factor, which is key to the high loan repayment rates experienced by micro-finance programmes in developing countries, and which is often based on the complete absence of support for the micro-entrepreneur from any source other than the micro-finance organisation, is far weaker in industrialised countries such as the UK, both because there are alternative forms of funding/support for clients and because loans are often not as high a priority for them.

> A second key to the high repayment rates achieved in developing countries is the power of the loan repayment enforcement process, (frequently from peer group pressure from co-borrowers). In a country (such as the UK) where social capital and related peer pressure is weak, group lending will not necessarily lead to high repayment rates. It may even have the reverse effect (32) Street UK has found that by removing the 'severability' requirement of loan guarantors, so that, for a £3,000 loan, for example, guaranteed by 3 people, each is solely responsible for £1,000 rather than all 3 being collectively responsible for the whole £3,000, guarantors have been more responsible in honouring their contractual obligations. This is because, with the 'joint and

(30) Where people are no longer eligible for their benefits because they are now in self-employment but the business is not yet providing them with the level of net income they received in the form of benefits, they will be worse off. 'Income bridge' schemes to address this issue do exist but are generally inadequate. More detail is provided on this problem and on possible solutions in Chapter 6.

(31) See the table at the end of Chapter 3, specifically the comments on the "lending model", for reasons.

(32) Street UK has found that by removing the 'severability' requirement of loan guarantors, so that, for a 3000 pound loan, for example, guaranteed by 3 people, each is solely responsible for 1000 pounds rather than all 3 being collectively responsible for the whole 3000 pounds, guarantors have been more responsible in honouring their contractual obligations. This is because, with the 'joint and several' arrangement, rather than guarantors' exerting peer pressure on each other, they have tended to feel less responsible and wait for the others to fulfil the group's obligation.

several' arrangement, rather than guarantors' exerting peer pressure on each other, they have tended to feel less responsible and wait for the others to fulfil the group's obligation. . The enforcement process is further undermined by the ineffectual court process in the UK, for this type of case (33).

> A third factor in successful loan repayment rates and possibly the most important of all, concerns the quality of the loan officer and their relationship with their client. It has not only been very difficult for Street UK, but also for most other community finance organisations in Britain, to recruit the calibre of front-line staff needed to achieve (both high loan volume and) high loan repayment rates. A highly skilled workforce is particularly needed because of the challenging nature of the work. This requires people who could otherwise be earning far more in the private sector.

## Funding issues

### Unrestricted grant funds are scarce

In general, the availability of unrestricted grant funds to support the institutional development of micro-finance organisations is scarce. More information is given in Chapter 6 on the specific funding issues and needs for practitioners. As regards the effect created by this problem and the strategies some of the most successful non-profit organisations in the UK have adopted in order to optimise their situation within the current environment, Street UK has observed and is largely adopting the following practices:

### Taking a more opportunistic and funder-driven approach to business development strategy

This includes becoming more flexible and adaptable to funding availability, in terms of the range of products and services offered, timetable for development or specific population groups and geographic areas served.

### Maintaining a low cost operation

This means minimising the total operating budget, even if it produces sub-optimal value, in order to contain the risk of not raising the subsidy required.

### Balancing the need for diversified funding sources against fundraising cost efficiencies

During its first three years, Street UK focused on maximising fundraising efficiencies, by raising large amounts from a few sources. This low diversification created major problems, particularly in 2002 (34).

### Developing as many sources of trading income as possible

These include both mission-related products and services and non-mission related opportunities, such as the delivery of public service contracts.

### Building a reserve fund

Street UK plans to achieve this by raising donations and capital from individual supporters and the general public.

## Organisational size issues

### Balancing economies of scale against the level of subsidy required

One of the fundamental assumptions behind Street UK's original business plan was that it needed to be a national-scale organisation in order to achieve the economies of scale which would enable it to be sustainable. Whilst economies of scale are still a crucial requirement, Street UK's experience has shown that they only start to come into force if the marginal financial contribution from micro-lending in one branch is positive, ie. if the gross revenue from its loans, minus its loan losses and capital costs, minus the local costs of a branch operation, provides a net positive contribution to central / head office overheads.

This has not only been difficult to achieve because of the very low loan volume, but also because the local costs of each branch operation have been recently increased by having to include a local fundraising function, very little of which can be centralised because the funder market for this type of activity / cause is mostly *not* national (35). Therefore, until a more sustainable activity can be developed, and whilst the economies of scale in micro-finance fundraising are low, the goal of achieving maximum economies of scale needs to be balanced against containing the absolute level of overall operating subsidy required within achievable fundraising limits.

(33) In general, the only clients that Street UK has been able to collect money from through the court process are those who do not already have country court judgements against them and are motivated to pay by the fear incurring a bad record for the first time. Once thay already have a bad record, the fear factor becomes far weaker.
(34) See Chapter 1, Background, Street UK History
(35) This problem was recently aggravated by the announcement of the transfer of responsibility for supporting CDFIs from central government to regional government. See footnote (6) for further detail.

This is one of the main reasons that Street UK has created a new business plan that is based on a retail operation that covers one entire (West Midlands) region only, rather than individual cities with high population densities, each located in different public funding zones.

## Sustainability issues

### Operating and capital costs

Apart from the higher loan losses already discussed, most of the operating and capital costs of running a micro-finance programme have turned out to be more or less as Street UK expected (36).There are two exceptions, however, the first being its transport costs. With the Hatfield rail disaster occurring one month after Street UK's launch and the entire rail network on which Street UK's geographic development plan depended becoming totally unreliable and hugely costly on journey time and expense, not to mention staff wear and tear (37), the regional hub and spoke branch development plan became totally unsuitable for the UK market. Unfortunately, however, it was not clear that this would be a 'permanent' state of affairs for some time.

### Cost of fundraising

The other unexpectedly high cost was for fundraising. With hindsight, the successful track record that both Street UK managers brought to the company from their previous organisations (38), ie. having developed them to a point of sustainability that meant they did not have to undertake any fundraising, was both a key factor in their being able to raise the initial £4 million with which they started Street UK and a key factor in their later difficulties, once it was clear that the company would need substantial further subsidies and that the fundraising function was critical to this. It is also worth mentioning that, had the fundraising function to create a national scale organisation been less difficult, the 18 months spent preparing for a merger with unLTD (39) and then unwinding the organisation, would have been unnecessary.

### Overall sustainability prospects

Due partly to these additional costs, but mostly to the much lower loan volume and somewhat higher delinquencies than anticipated, Street UK no longer believes that it is possible to create a fully sustainable organisation by offering *micro-loans only*. It has, however, demonstrated that it is possible to cover at least the loan loss plus capital costs of a micro-lending operation from interest and fee income and make some contribution towards its overheads.

Street UK still considers that it should be possible for micro-finance organisations to become sustainable, but by a combination of adding to their revenue streams, reducing their costs and finding synergies with other organisations through partnerships. A number of alternative strategies, many of which are already being pursued by Street UK and other organisations, are dealt with in the following section.

## Strategies for sustainability

### Adding to revenue streams through new products

> Developing a greater range of products and services targeted at *micro-enterprises*. These could include business or financial advisory services, other credit products such as leasing and insurance and other financial services. Street UK is currently pursuing this strategy with its leasing product.

> Developing additional consumer finance products for *micro-entrepreneurs*, eg. personal loans, mortgage financing or bill paying services. Street UK now offers, for example, personal loans to micro-entrepreneurs.

(36) The unit cost of supporting one client has been much higher than expected, however, largely because of the low client volume.
(37) Approximately 150 extra nights away per person per year were required for the line manager and credit manager to be able to provide sufficient training and support to the front line staff. A lower level of support would have been insufficient to make sound credit decisions, given the low levels of financial literacy amongst clients. Other CDFIs have got around this problem by a) staying local and b) having a credit committee made up of volunteer board members rather than staff.
(38) Fundusz Mikro, the micro-finance organisation in Poland which was founded and developed by Rosalind Copisarow, became a sustainable organisation within 5 years. ICOF, one of the first social finance organisations in Britain, was developed by Martin Hockly into a cashflow-positive organisation, with 50% of its income being generated from client interest and fees, and the other 50% from investment of its capital.
(39) See footnote (5)

### Adding to revenue streams through new markets

> Adding new retail markets, for example *small businesses, social enterprises and individuals* without access to mainstream financial services. Personal loans to low income individuals have become a significant part of a number of CDFIs' activities in the UK, for example the Community Reinvestment Trusts (40).

> Diversifying into the *wholesale market* of community finance organisations and other non-profit loan funds as a niche market service provider. Street UK is currently pursuing this market through its StreetServe back-office loan administration product.

> Becoming a government contractor for *public service delivery* eg. for the provision of educational, neighbourhood regeneration or community services. A distinction is made here between government contracts for service delivery and government grants to subsidise loss-making activities. Prince's Trust, for example, receive a fee from the government for each person they help come off the unemployment register.

### Finding synergies with other organisations through partnerships

> Offering micro-finance activities as an *additional or secondary function* within an already sustainable organisation such as an enterprise agency or housing association, where they only need to cover their marginal costs to be viable. The CDFI Change, for example, was set-up by London & Quadrant, one of the largest housing associations in the South East, and is now coordinating a number of other housing association partners' community finance activities.

> *Merging* with other community finance organisations to achieve greater economies of scale, *co-locating* with other organisations or forming *cost-sharing* partnerships such as is proposed through a new community banking partnership model (41). This combines the strengths of credit unions, community finance organisations, money advice agencies and other financial and support providers, to provide, between them, an integrated range of tailored financial services.

> Creating other forms of *partnership*, for example between commercial banks or insurance companies and community finance organisations, to offer tailored products to financially excluded markets; or partnerships with government, to deliver publicly supported financial services such as a nationally rolled-out incentivised savings scheme.

## Key elements of new business plan

Street UK's post-pilot business plan has two main elements to its operations:

> A regional focus for its retail micro-finance operations, including the development of additional products and services for micro-entrepreneurs.

> The provision of wholesale services to support the market of community finance organisations and loan funds throughout the UK.

### Retail operations

Until its micro-lending operations become more sustainable, Street UK plans to develop its retail operations across the West Midlands region only, by opening branches within the next 2 years in the Regeneration Zones of East Birmingham, West Birmingham/Dudley, Black Country/Wolverhampton, Coventry & Warwickshire and Stoke-on-Trent. Wherever possible, the branches will be located within partner organisations' offices, in order to maximise client referrals, minimise operating costs and generally integrate more quickly and easily into the local communities.

By developing its operations throughout the whole region, Street UK expects to achieve:

> Some economies of scale in staffing costs (in terms of the number of loan officers per region manager).

> The capacity to serve smaller towns than is currently possible, because the smaller distances between towns will enable 'mobile' loan officer positions to be created, with 'hot desks' in different towns.

(40) The Community Reinvestment Trust model, promoted and operationally supported by Community Finance Solutions, is based on an approach which includes personal loans for low income individuals, particularly those who are tenants of housing associations, housing-related finance and enterprise development finance. See www.communityfinance.salford.ac.uk.
(41) This model is being supported by a partnership of Community Finance Solutions, the National Association of Credit Union Workers (NACUW) and NEF.

> Significantly reduced travelling costs.

> Closer management supervision/support.

In addition, it expects to reduce the time needed for (particularly public sector) fundraising and increase its capacity to deliver public funders' objectives.

## Wholesale operations

Street UK has started to develop a second strand of activities to support the market of community finance organisations and loan funds. Its particular objectives are to:

> Act as a mechanism to serve its national mission, by supporting other organisations throughout the UK.

> Generate a significant source of additional trading income.

> Create additional value from, and share the benefits of, the investment it has already made in its own retail operations.

> Increase its attractiveness to public funders, by providing them with a capacity-building mechanism to increase the provision of community finance activities and business support to micro-entrepreneurs in their geographic area.

As its first product, Street UK has introduced StreetServe. This is a support service for any non-profit organisation making loans, whether to micro-enterprises, small businesses, social enterprises or individuals. In particular, it covers:

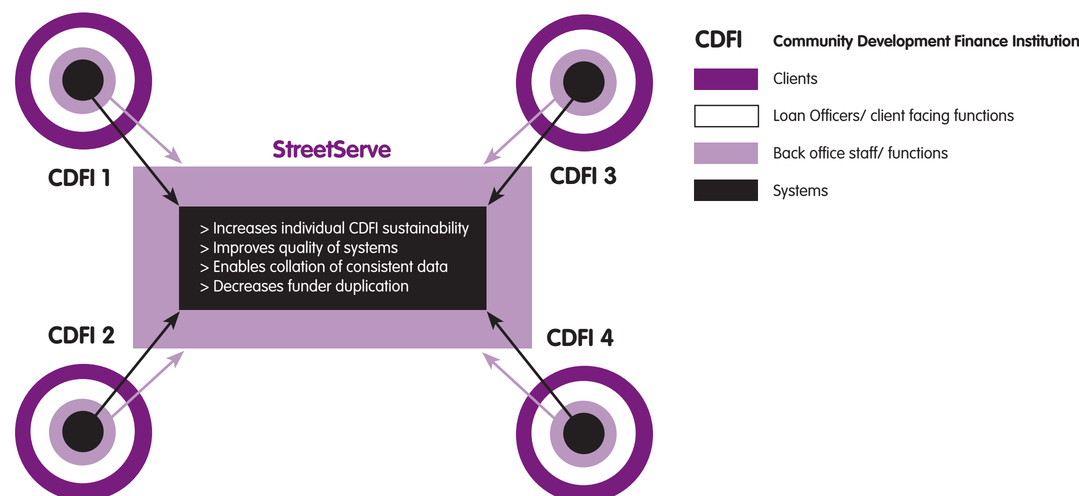
> *Systems support:* including the software which Street UK has developed to underpin its own operations, future software upgrades, 'remote' hardware and telecommunication lines needed for the service, data storage and data protection facilities, as well as staff training on the usage of the system.

> *Operations support:* to handle any of the following: telephone enquiries from its clients' potential customers, credit checks through a credit agency, loan disbursements and repayments, client account statements, arrears-monitoring, and any/all credit control functions, including coordination of the court process.

> *Analytical reports, documents and tools:* including socio-economic analyses of enquiries and clients, output monitoring and loan portfolio performance reports, client application forms, loan agreements, internal credit analysis forms, documentation checklists and direct debit mandates; as well as remote management tools such as the Client Diary system which enables a remote view of the relationship management activities of every loan officer with each of their clients.

The diagram below is intended to show how the activities and costs of every community loan fund can be substantially reduced by eliminating all the functions that can be handled remotely. This enables a much higher proportion of the local resources to be spent on direct client support. At the same time, the quality of the remote services can be significantly enhanced by combining and pooling the investment in their development.

## Benefits of StreetServe to the CDFI sector as a whole



# Chapter 5

## Funding issues
## Lessons about the terms and conditions of support needed from funders

**Having raised a mix of funds from the public, private and voluntary sectors, Street UK's experience with each has resulted in the conclusion that significant changes are needed in their terms and conditions and/or approach if the micro-finance sector is to develop on a sustainable basis.**

**This chapter sets out the specific issues which need to be addressed by:**

> Government
> Commercial banks
> Foundations
> Individuals

**The issues are then summarised in a table.**

The issues which Street UK has encountered in relation to its funding requirements are numerous. This is particularly because micro-finance, and community finance in general, is a newly recognised sector which has yet to be widely understood. In addition, it is a sector which lies between the philanthropic, commercial and public service spheres, meaning that organisations can potentially raise funding from foundations, government and commercial banks. However, the challenge of such a fundraising approach is responding to respective funders' separate goals and perspectives without undermining the integrity of the organisation's own goals and business model.

## Government funding issues

Whilst financing from the private sector is clearly an important element in the funding requirements of community finance organisations, the biggest immediate need is for core funding for their operations until they are able to become financially self-sufficient. In addition to this, equity capital is needed to fund the clients themselves. The government should be the main funder for this source of support, because community finance institutions will be delivering some of its key objectives, particularly in the areas of education and skill development, regeneration of deprived neighbourhoods, small business and job creation, as well as providing indirect benefits in the areas of health, law and order.

Government support to community finance organisations should not only help to prevent many socio-economic problems but also, over the medium term, cost less than the current levels of public spending in each of these areas. In order to be able to quantify this benefit more precisely, however, the government needs an *investment* approach to replace its current *expenditure* approach.

The biggest issues which particularly concern the terms of government grant programmes are set out on the following two pages.

### Support for new, pioneering activities

There is currently a lack of interest or ability by government to support new, pioneering activities in an entrepreneurial way, i.e. to accept the risks of failure and the requirement for new objectives or new performance measurement criteria and indicators as well as new initiatives per se. Perhaps the most challenging of all for the government is its willingness to potentially divert its support from existing traditional delivery organisations, if the new approach proves more effective. Street UK's observation is that, despite a large number of new initiatives, there is an underlying resistance to real change which dilutes the practice of the intended innovations within these new initiatives and is a drag factor on the rate of progress.

### Transparent process for obtaining funding

This concerns the degree to which new entrants to the market of government grantees can understand the real agenda and process for obtaining public funding. Again, Street UK's experience is that this is currently too opaque, sometimes non-meritocratic and needs to become much more transparent.

### Support for institutional development

There is a lack of appreciation in government for the fundamental elements of supporting institutions, as opposed to projects. The purpose of the Phoenix Fund, which Street UK was actively involved in helping to create and develop, was supposed to be to support the institutional development of CDFIs and a strong community finance sector in general, that would operate over the long-term and on a sustainable basis. The main criteria by which the government provides its support, however, are unfortunately in direct opposition to this objective. Specifically:

### National (as well as regional and local) scope

A national fund is critical for organisations, such as those engaged in micro-finance, that need to achieve very large economies of scale in order to cover their costs. With the discontinuation of the Phoenix Fund and the expectation that CDFIs should raise ongoing government support from Regional Development Authorities, there is no longer the possibility of creating these economies of scale.

### Transition strategy for Phoenix Fund

Although the recent government spending review (42) has allocated some funds to support the transition from central to regional government, it is a transition strategy that is required, not only to ensure that these funds are sufficient but also to inform or educate regional government officials on the nature of the community finance sector's support requirements.

### Long-term investment

An additional key element of institutional support is long-term investment. Ideally, funders need to commit financing on a 5–7 year basis, rather than the current 1–3 year basis, if the organisation's capacity-building is to be more systematically undertaken.

### More geographic flexibility

The geographic restrictions of much public funding can be problematic for building community finance institutions. Leaside Regeneration (43), for example, made a major grant of £440,000 to support Street UK's East London pilot activities. However, the only 'primary outputs' from its investment were the loans that Street UK made within its geographic boundaries. The Leaside area not only has a small population size relative to the minimum needed for a micro-finance organisation to warrant setting-up a branch, but also a relatively low number of already existing micro-enterprises (to support with loans) because of the general level of deprivation in the area. Because Leaside Regeneration recognised the importance of the overall mission and potential impact of Street UK, it was willing to contribute to the start-up costs of the organisation, recognising that a fair proportion of its funding would benefit areas outside of its own. This is an unsatisfactory arrangement, however, relying on the personal goodwill of individuals. Generally, less restricted funding is required to build geographically spread institutions.

### More flexibility over clients served

Another area of tension concerns the propensity of government to support particular target groups only, usually defined by their disadvantage, rather than by their capacity or, in the case of micro-finance, their creditworthiness. Street UK believes there is a direct conflict in government between its stated objective of supporting strong CDFIs and its wish to micro-manage the CDFIs' client selection. Funding for women, ethnic minorities or ex-convicts only, for example, may push the organisation towards either serving someone who is not creditworthy or towards refusing someone who is (because they are the 'wrong' race or gender, for example). The protection for funders that their support will help the disadvantaged should be contained within the CDFI's mission and business plan.

### Integration of support for personal and business finance

As regards products and services, there is a further 'disconnect' between the government department that is interested in supporting enterprise lending (the Dti/Small Business Service) and the departments interested in supporting personal lending. (The latter is mostly a Treasury interest, with no Spending department clearly responsible). Micro-entrepreneurs, in particular, have a need for their personal and business finance service provision to be integrated.

### More support for existing initiatives

A further hallmark of government support is its keen interest in new initiatives at the expense of ongoing support for existing initiatives. This may seem to be a contradictory comment in relation to the previous point about the government's general risk-aversion and lack of appetite to support untested activities, but is actually an additional obstacle because, on the one hand the initiatives must be 'new', and on the other, they must have a proven chance of success.

### More flexibility in matched funding rules

Many types of government funding require matching funds to be provided. Whilst the principle of this requirement is understandable, the way in which this condition is implemented can create considerable problems. For example, commercial bank financing may not be acceptable as match funding for a

(42) The Comprehensive Spending Review for 2006-2008, announced by the Chancellor of the Exchequer on 12 July, 2004.
(43) Leaside Regeneration Ltd was brought into existence in 1998 by the London Borough of Tower Hamlets, to develop and deliver regeneration programmes in the borough. Leaside Regeneration operates in the north eastern quarter of Tower Hamlets and in the Lower Lea Valley.

government grant or, if the timing of the match funding does not coincide precisely, it may again be disqualified. A better system would be to follow the private sector approach, which is simply to limit the amount of the funding to a fixed proportion of the total funding as well as to an actual amount.

### Payments in advance of expenditure

Finally, the practice of paying out grant funding three months in arrears can create major fundraising and cashflow difficulties. Public funders often expect an organisation to already have the funds in place to undertake the activity, and yet prove that they do not have the funds in order to show why they need the grant. This is an anomaly that needs to be addressed. Furthermore, few small organisations can easily manage the cashflow implications of payments made so far in arrears. Ideally, payments should be made in advance, but even one month in arrears would be better than the current situation.

# Bank funding issues

The issues with regard to commercial bank support for CDFIs revolve to some extent around the terms and conditions of their financing, but more around the overall level of support that they should provide to the sector and the specific roles they might play.

## Connecting business and charity departments/budgets

One of the challenges for banks to provide suitable terms and conditions for community finance organisations concerns the issue of whether this is regarded as 'business' or 'charity' and how to handle the internal organisational aspects of financing structures that lie between the two. Many banks have been supporting community finance organisations from their corporate social responsibility or community departments and budgets. Barclays, however, after two years of discussions with Street UK, have pioneered a new lending model, involving capital from their commercial (corporate banking) operations, and a charitable donation to provide an internal subsidy on the interest rate, such that the net pricing charged to Street UK on the loan is 1% over £ Base rate. This model is beginning to be adopted by other banks and is now used with other community finance organisations.

It is not a long-term proposition, however, in any bank where the commercial department's lending risk is fully underwritten by the charitable department, as there is a limit to the amount of risk capital that can be internally underwritten. With the imminent entry into the market of the first dedicated wholesale loan funds for community finance organisations, progress has been made to create a market of true 'intermediate funds'. Further changes are still needed, however, to provide sufficient appropriate support for the growing community finance sector as a whole.

## More intermediate wholesale capital

Whilst it is clear that commercial banks need to play a significant role in supporting the community finance sector, it is unlikely that they will do so on a substantial basis whilst (a) such activity is not deemed to bring positive business benefits, and (b) all support is voluntary rather than compulsory. In these early days of the sector's development, with the majority of institutions still not sustainable and commercially creditworthy, there need to be clear government incentives or mandatory regulation for bank support if those banks which are most well-intentioned are not to suffer competitive disadvantage from their support. Chapter 6. provides further details on the positive US experience of introducing both a compulsory minimum investment requirement and a set of return-enhancing or risk-reducing incentives for further investment (44).

Beyond these government 'sticks' and 'carrots', two additional components are needed to increase commercial bank investment in disadvantaged communities: CDFIs themselves must improve their performance and creditworthiness as well as their transparency of reporting (45); and banks should consider co-investing with public funders or foundations, which are more able to offer concessional financing.

(44) See references to the Community Reinvestment Act, Bank Enterprise Award Scheme and the Capital Access Program in Chapter 6.
(45) Part of the process to provide more transparent reporting involves the creation of a standardised set of performance definitions and measures throughout the sector. The CDFA has started to work on this issue, but more cooperation is needed from practitioners themselves (and pressure from funders) if significant progress is to be made.

## Additional ways of supporting CDFIs

Besides wholesale funding for CDFIs, commercial banks can play several partnership roles including:

### Client referrals

Establishing referral systems for the loan applicants that they reject, as part of their normal bank branch business policy. Two pilots in which Street UK is participating are currently in process – one with HBOS and the other with Barclays. However, these are both in respect of small business loan applications. A bigger need for micro-finance organisations is for retail (i.e. individual) loan referral schemes, since micro-entrepreneurs are most likely to have sought financing from banks on a personal basis, if they lack a formal small business track record.

### Technical support

Sharing physical infrastructure and technical systems, or providing training, technical expertise and/or documentation, as well as staff on secondment or volunteers to CDFIs. This would be particularly valuable in non-client facing areas (such as back-office), where banks and CDFIs have the most in common, and where the high levels of expense involved provide some of the greatest cost savings for CDFIs.

### Partnerships

Partnering on new product development, either by means of working with a CDFI to tailor an already existing product to the specific needs of their market and having them undertake the outreach and client relationship management (46), or together providing a delivery partnership to the government on a scheme such as the Savings Gateway programme to incentivise savings. Here the matched savings subsidy could come from government, the savings account infrastructure from the bank and the client relationship management function from the community finance organisation.

# Foundation funding issues

## Support for new initiatives

In terms of the type of funding that micro-finance organisations need (until they are sustainable), foundations are in some ways better suited as funders than government, banks or individuals, because they have more freedom than the government to set appropriate terms and conditions, more capacity than commercial banks to provide the grant support needed to subsidise operating deficits and more funding than most individuals, as well as funding that does not require tax relief for making a donation. Foundations are also most able and willing to support pioneering activities in new fields of endeavour, with higher than average risks (47). Once a track record of experience has been established, and the activity has been proven to be worthwhile, other funders should be able to provide continuation and further development finance.

## Venture philanthropy approach

There are nevertheless considerable differences between the terms and conditions of grant support which would be most helpful to micro-finance organisations, otherwise known as venture philanthropy, and the typical terms of grant support provided by foundations. In the table below, based on a paper by Henry Drucker (48), the key elements of venture capital are compared with traditional foundation support. Venture philanthropy is a term that has been created to combine many of the terms and conditions of venture capital with the social objectives of foundations. Clearly, the reality of the way individual foundations provide support is neither as uniform, nor as stereotypical as the table suggests. It is simply provided here in order to illustrate the principal issues involved.

(46) This type of partnership should also apply to insurance companies for the development of tailored insurance products.
(47) Street UK's experience in this regard was extremely positive, with invitations from four UK foundations to make direct presentations to their trustees, each resulting in a grant being awarded. These were World in Need, City Parochial, Esmee Fairbairn Foundation and John Ellerman Foundation.
(48) "Wanted: UK Venture Philanthropists", by H. M. Drucker, Oxford Philanthropic.

**Comparison of Venture Capital vs. Foundation Approaches,** by Henry Drucker

| Relevant practice | Venture capitalists | Foundations |
|---|---|---|
| Amount of funding | Substantial commitment to provide significant capital and help raise additional current and follow-up capital. | > Partial commitment - will provide small part of total needed capital.<br>> Non-profit organisation must continue fundraising independently. |
| Length of relationship | > 5-7 years<br>> Linked to success | > 1-3 years<br>> Arbitrary |
| Terms of engagement | > Joined at the hip<br>> Small portfolios<br>> Partnership | > Arm's length<br>> Large portfolios<br>> Oversight |
| Risk management | > High degree of shared risk<br>> Funds are lost when project fails | > Low risk for foundation, high risk for non-profit organisation.<br>> Funds themselves not 'at risk' (because they must be spent) |
| Organisational capacity -building | Funding to build capacity to successfully execute business plan. | Funding primarily for programmes not personnel, infrastructure or overhead. |
| Performance measures | Clearly defined rewards and risks for all. | > Funder: reward is largely in grant-making.<br>> Non-profit organisation: reward is in outcome. |
| Exit strategy | 2 stars, 2 failures,<br>6 walking dead or wounded. | > 'Myth' of government take-over.<br>> Burden on non-profits. |
| Results | Capital support for 1% of all start-ups but 30% of companies that reach Initial Public Offering of shares. | Harder to know. Not quantified.<br>Same potential to support organisations to getting to scale? |

The key elements of venture philanthropy, such as long-term support; close involvement with the company's development; providing the capital for institutional capacity-building; and taking a more statistical approach to risk; are still mainly absent but greatly needed amongst foundations in the UK.

## Action research for start-ups

There are also particular terms and conditions that need to apply to start-up organisations. These concern the performance targets that are agreed between the grantor and grantee. In general, the first few years of an organisation's activities should be regarded as action research and market development such that, if output targets are set, they are regarded as soft rather than hard targets. This should enable the decision regarding the continuation of support for the organisation to be based on the overall picture of whether it is providing sufficient added value, rather than the extent to which the original quantitative output expectations have been met.

## Special responsibilities for large grants

Another element of grant funding which warrants attention concerns situations where the grantor makes a very large grant, either in absolute or in relative terms, (eg. is the majority funder to the organisation). The additional responsibilities of such funding need to be recognised by both parties, to the extent that any temporary or permanent interruption or cancellation of such funding could well lead to the liquidation of the organisation. It is therefore particularly important that the terms and conditions of such funding be made absolutely clear, both at the beginning and, if there are any changes, along the way.

## Incorporation of a learning element

It is also worth incorporating a learning element into every large grant so that the benefits of the grantee's experiences (whether good or bad) can be

shared with a wider audience. This practice is unlikely to become widespread, however, unless some measure of protection is built in, particularly for the grantee, so that they are not disadvantaged by their honesty. Perhaps one way to address this issue is to have foundations collaborate with each other to promote a greater learning culture in general, so that it becomes normal practice across the voluntary sector.

## Support at the maximum affordable price/cost

Bearing in mind both the micro-finance industry's intermediate position between commercial finance and philanthropy, and the relatively limited supply of grant support vs. commercial capital, grant funders should be encouraged to support micro-finance organisations only to the extent that non-commercial capital is needed. This will preserve the grantors' funds for those projects least able to become sustainable (e.g. helping the hungry and homeless, where there is no income generation from the beneficiaries to enable the organisation to become sustainable). It will also maximise the efficiency and impact of the overall allocation of resources. This can be achieved by having the grant funder underwrite the risk for a commercial bank to lend to a micro-finance organisation, or by providing equity capital to underpin the bank's loan.

Whilst it may seem counter-intuitive to a foundation (or government) to have their funding support a profit-maximising organisation (rather than directly support the ultimate beneficiaries), this does in fact provide a far higher ultimate social return on their capital, by providing the leverage for an increased level of funding to reach the beneficiaries supported (49).

## Provision of intermediary finance and use of endowment capital

There are also opportunities for intermediate finance to be provided solely by foundations, using a mix of their endowment capital and their income used for grant-giving. In the USA, 'mission-related investments', introduced and promoted by the Jessie Smith Noyes Foundation (50) have become a widespread practice to reduce the dissonance between the profit-maximising objectives set for a foundation's endowment capital and the social objectives set for its income, as well as to increase the total social impact from the foundation's funds. Program-Related Investments, introduced by the Ford Foundation to offer low cost, long-term financing to charities, are also partly made from the endowment capital of the foundation and provide a very helpful alternative form of intermediate finance. In the UK, Esmee Fairbairn Foundation has pioneered similar support to charities with its own loan programme and its investment in one of the UK's first venture philanthropy firms. It is very much hoped that other foundations will follow their lead.

In relation to Street UK's experience, on the one hand, it was hugely supported by the Esmee Fairbairn Foundation, in terms of the major level of funding EFF provided, its willingness to invite Street UK itself to propose the initial (loan) targets, the extra time and effort it put into managing the grant and its decision not to terminate the grant completely when the initial loan targets were not met. On the other hand, this support was provided in a 'traditional' way: i.e., as arm's length support (in the sense that there was no management involvement); was tied to the development of three

(49) Micro-finance has justifiably been criticised for not using the same standards of self-help that it expects from its clients in respect of its own funding. Specifically, this means it has been 'greedy' in not limiting its non-commercial support to the minimum level that it can manage with. As a result, it has potentially left the truly destitute with inadequate support. If one assumes that pure grant funding is the most limited form of funding available and commercial capital the most unlimited, a concept of Optimal Project Funding needs to be introduced, whereby funds with the highest affordable cost of capital are allocated to any given project or organisation.
Under this concept, if a project only needs partial grant funding and the rest can be equity or debt, then it should not take grant funding for the whole. It also suggests the need for a measurement tool to help investors/donors equate preferential financing terms to commercial terms plus a grant equivalent. Projects requiring funding would then be evaluated and compared along a 'subsidy spectrum', as well as in relation to their goals, achievements or outputs. As a result, much more 'socially-directed' funding should become available, requiring rates of return ranging from part-grant, part-capital-retention to 'ethical' investment rates, a few points below pure commercial rates.
A further measure to attract new such intermediate capital is an appropriate tax exemption, in order to fill the gaps between
(a) 40% tax relief for standard charitable donations; (b) 5% tax relief for investment into accredited CDFIs; and (c) no tax relief for most forms of investment in for-profit companies.

(50) See Jessie Smith Noyes Foundation 1998 annual report, President's essay, which contains responses to frequently asked questions about mission-related investing.

locations for pilot *lending* only; and required hard, quantitative targets to be met, rather than softer institutional development targets more suitable to a start-up *organisation to support micro-enterprises.*

As a result, there was a significant 'drag-factor' on the development of higher priority products and services to support its clients, once Street UK realised (in 2002) that other financial and business support services were at least, if not more important. In addition, EFF's grant of £1.3 million represented over 70% of Street UK's initial grant funding and yet the terms and conditions of the continuation of grant support were not always clearly expressed or understood, resulting in serious consequences for the company when the funding was frozen (51).

## Individual funders' issues

As yet, the market of individual donors to community finance organisations is very limited and more or less restricted to investors in accredited CDFIs, enabling them to qualify for the newly introduced Community Investment Tax Relief (see Chapter 6, Tax Policies for Investors). This reflects the general conclusions of a recent report by Philanthropy UK (52) on the motivations and disincentives for wealthy people in the UK to give which, inter alia, include a call for much better fiscal incentives, simplification of the administration involved in claiming tax relief and a change in the whole culture of giving.

A summary of the main points in this chapter is provided in the table below:

## Summary of funder issues

| Government | Banks | Foundations |
|---|---|---|
| Institution-building vs. project funding approach, including:<br>> National funding (as well as regional and local)<br>> Transition strategy for Phoenix Fund to ensure continuity of RDA support<br>> Long-term commitment<br>> Minimal geographic restrictions<br>> Minimal target group restrictions<br>> Integration of personal and business finance, and non-financial support<br>> Easier matching requirements<br>> Support for project continuation, not just new pilots<br>> Payment preferably in advance (or maximum 1 month in arrears) | Both financial and non-financial support needed from banks, including:<br>> Wholesale funding for CDFIs<br>> Systematic referral of clients<br>> Sharing infrastructure and systems<br>> Providing training, technical expertise and staff<br>> Partnering on new product development<br>> Tailoring existing banks' products<br>> Similar product development partnerships needed with insurance companies | Clear terms and conditions<br><br>Appropriate performance targets for start-ups<br><br>Special responsibilities where grantor is majority funder<br><br>Evaluation / learning / feedback element with large grants<br><br>More intermediate finance, eg. soft loans or investments |
| Transparent process | Suitable internal organisation structure / budget allocation to provide intermediate terms and conditions | Venture philanthropy elements needed:<br>> Long term commitment<br>> Institution-building approach<br>> Close involvement / board<br>> Positive attitude to risk / failure |
| Appropriate support for new, pioneering initiatives | CDFI performance and transparency, and government enforcement and incentives needed, for banks to invest more in CDFIs | Optimal project funding approach, resulting in co-investment with or underwriting of commercial funds |

(51) Because the intention, or even possibility, of the foundation halting its grant funding in the event that Street UK's planned merger with unLTD did not proceed, was not stated at the time when permission was first given for the merger, the subsequent sudden halt to Street UK's funding was one of the key factors that led to the organisation's near collapse in early 2002.
(52) Lloyd, T. "Why Rich People Give", pub. Philanthropy UK, June 2004. A summary of the study is available on the company's website: www.philanthropyuk.org.

## Conclusions

> With micro-finance lying between philanthropy and commercial finance, the most appropriate funding will come from intermediary forms of finance, along a spectrum ranging from completely philanthropic to completely commercial. This is still an embryonic market, where there are major opportunities for the development of new financial instruments ranging from patient equity capital to semi-commercial debt. Some of these instruments may be able to be created through partnerships between private, public and voluntary funders.

> The biggest immediate need is for core funding for community finance organisations' operations, until they are able to become financially self-sufficient. Although foundations have been very helpful in providing much of the initial funding for this source of support, the government should now increase its role of providing ongoing core funding, both because community finance institutions now have a small but significant track record in providing effective support to their clients and because they will be delivering some of the government's key objectives.

> There is a great need for the type of funding provided to be based on the principles of venture philanthropy, particularly in the early years of an organisation's development, allowing institutional capacity-building.

> In order to ensure that there is sufficient interest by investors to place funds into each of these new intermediary forms of finance, the fiscal incentives need to be appropriate to the level of financial sacrifice required from the investor relative to the return they could have obtained from a commercial investment. In other words, the system of tax relief should be designed as a sliding scale and equated to the degree of financial sacrifice involved with each intermediary instrument.

> Beyond fiscal incentives, the government also needs to provide a range of additional return-enhancing or risk-reducing incentives, as well as mandatory regulation to leverage further investment into CDFIs from both commercial and non-commercial sources.

> For financial institutions, the provision of intermediary finance will require changes to their internal organisation structure to enable them to respond appropriately to the needs of the market, while for foundations and trusts, changes to their investment policies, and possibly to the regulatory framework for investing their endowment capital, will be needed.

> In addition to providing financial support, funders can play a very helpful role in a number of other ways, particularly commercial banks, whose own activities have much in common with those of micro-finance organisations.

# Chapter 6

## Policy and regulatory issues
## Lessons about changes needed

**This chapter examines the most serious external constraints on the development of the micro-finance sector, by setting out the main policy and regulatory issues where Street UK has experienced significant obstacles and, wherever possible, recommends solutions.**

**The issues are classified into:**
> Those which affect micro-entrepreneurs
> Those which affect micro-finance organisations that serve them
> Government organisational issues which affect them both.

Based on Street UK's experience, and that of other organisations with which it has worked, there are a number of policy issues which it believes need to be addressed, if low income micro-entrepreneurs are to be able to advance into mainstream society and develop their businesses to become sufficiently creditworthy for CDFIs to support them into mainstream bankability (53) (54). These issues may be classified into three categories: those which directly affect the micro-entrepreneurs themselves, those which affect the organisations that directly support them and those which are specific to government.

# Summary of Policy issues

| Micro-entrepreneur issues | Micro-finance organisation issues | Government organisational issues |
|---|---|---|
| Education / lifelong learning | Definition of charity | Re-defining objectives and desired outputs |
| Business advice and support | Not-for-profit legal entity | Creating multi-pronged solutions through joined-up government |
| Small business regulations | CDFI regulatory framework | Linking dept./agency databases |
| Tax and welfare policies<br>> Extended eligibility for support<br>> More carrots vs. sticks<br>> Three building blocks<br>> Tax and benefits co-ordination<br>> Streamlining benefits thresholds<br>> Increasing beneficiary control | Enforcement of minimum bank investment<br><br>Tax policies for investors<br><br>Incentives for further commercial and non-commercial investment | Increasing role of voluntary sector in designing and delivering public policy |
| Over-indebtedness & savings | | |

# Micro-entrepreneur issues

## Education / lifelong learning

Street UK has found that many potential clients lack the basic education and skills necessary to run a formal business and become bankable. This has highlighted the importance of upgrading and expanding business-related education and skills development for both children and adults.

In particular *for children*:
> The National Curriculum needs to be developed to include more content on 'business and the world of work'.

> At secondary school, the ethical issues for and against doing business in the informal economy should be openly discussed. In particular, Street UK believes that the message that informal business activities are illegal, detrimental to becoming part of mainstream society and avoidable, need to start at a young age in order to overcome generations accustomed to informal economic activities as a normal part of life. There is also a need to discuss the issue of paying tax as a normal part of citizenship.

> Entrepreneurial skills need to be further supported, particularly in schools in deprived areas, where the students have fewer future employment opportunities. One objective would be to re-direct young people's illegal (as opposed to grey/informal) trading activities into more positive channels (55).

> Generic financial management skills are also crucially needed, both for young people and adults. These include both personal financial skills, such as basic household budgeting and some financial planning capacity; and business finance skills such as cashflow management for enterprises.

(53) This paper is only able to highlight the main issues. More detail is provided in 'Self-Employed People in the Informal Economy - Cheats or Contributors? Evidence, Implications and Policy Recommendations' by Copisarow, R. and Barbour, A.(2004), including reference to the specific existing policies and programmes that need introducing, expanding, changing or removing.
(54) If these issues were to be addressed, many of the causes of low loan volume referred to in the Size of market / loan volume issues part of Chapter 4, would be eliminated, enabling micro-finance organisations to reach many more people and become sustainable organisations.
(55) The National Foundation for Teaching Entrepreneurship (NFTE) has an excellent programme which could be relatively easily rolled-out nationally.

While *for adults:*
There is a need to increase the options and choices of business training available and be more client-sensitive in their design, particularly in respect of poorer, less educated communities who need them most.

Three key priorities for adults are:

> Developing more experienced-based business training. For a lot of small business people, their preferred learning method is through experience rather than theory.

> Understanding the basic principles of the tax system. More information dissemination is needed, for example, on the business expenses which can be legitimately deducted for tax purposes, so that those people who would not in fact be tax-payers after deducting their legitimate expenses, or would end up paying very little, can become legal without it costing them as much as they feared.

> An upgrade in the recruitment process and training of business mentors, together with the development of 'wholesale' business decision-making tools for mentors, to raise the quality and consistency of the whole mentoring profession (56).

## Business advice and support

The type of business advice and support available to people seeking to transfer their businesses into the formal economy needs to be designed in an entirely different way from the current approach, which caters solely for people willing and able to go through a formal business planning process, and is used by Business Links and other government delivery agencies, for start-up or growth businesses. In particular:

> A specialised, separately branded activity of (or offshoot of) Business Links needs to be created, to focus specifically on the particular requirements of the micro-entrepreneur market.

> Informal economy transition or 'formalisation' business advice and support should become a recognised activity for which public funding is made available and appropriate targets are developed. The type of organisations most appropriate to deliver this advice and support need to fulfil two criteria:
- Specialised business and finance expertise in dealing with this niche market.
- High levels of cultural sensitivity and community embeddedness.

> Greater availability of certain government agencies at a local level would be useful e.g. the Inland Revenue's Small Business Support teams which, where they exist, provide excellent, confidential advice and knowledge within high street premises.

> A new type of 'business incubator' is proposed, focused on the multi-faceted requirements of the micro-entrepreneur market, where their business and personal issues can be addressed in an integrated way. The purpose of the 'incubator' would be to provide a free market of products and services within a one-stop shop for business support, finance and (legal, tax, debt, and benefits) advice. This should fill the gap in business and

**Business incubator products / services**

| Finance | Advice | Business support | Trade services | Information / Publication | Other facilities (57) |
|---|---|---|---|---|---|
| Grants | Legal | Consultancy | Book-keeping | Library | Commercial space for cash & carry, and wholesalers |
| Barter (58) | Tax | Training courses | Tools / Equipment rental | CD / bookshop | Café |
| Loans | Regulatory | Self-help tools | Equipped premises rental | Internet access | Creche facility |
| Savings | Benefits | | Marketing materials | Notice board for seminars, events, offers | Toilets |
| Insurance | Debt | | Printing services | | Cash machines |
| Equity | Business (signposting) | | Secretarial services | | Interpreter / translation |
| | | | Meeting rooms | | |

(56) Street UK has developed the initial concept for interactive business decision-making tools specifically to meet the needs of micro-entrepreneurs, and envisages that these could be provided with a qualified bookkeeper-cum-trainer, on a transitional basis, until the micro-entrepreneurs are comfortable using them by themselves.
(57) Many of the services in this category have been especially requested by clients of the Financial Inclusion Newcastle pilot support centre.
(58) BarterCard International, a private ('for profit') company originally from Australia but now based in 13 countries, has been very successful in developing low cost financing through barter, specifically for small businesses. In the UK it has over 2,000 members/clients. See www.bartercard.co.uk.

finance services, between those available for consumers and those available for the smallest of businesses. As a result, the thresholds for informal micro-businesses to progress should be lowered to a manageable level. The table on page 52 gives the range of the products/services it could provide.

## Small business regulations

A further obstacle for micro-entrepreneurs concerns the amount of regulation and red tape required to run a business. The more excessive this is, the greater will be the population of businesses operating in the cash economy, either because they are unable to afford the costs of 'going legit' or because the paperwork is too complicated to understand.

A common sense approach to the health, safety and consumer protection issues involved is therefore proposed in respect of each trade or industry sector for micro-enterprises, ie. where the business has no more than five employees. This could be achieved by means of specific exemptions. For example, public liability insurance (required for all businesses) would continue to be required for a builder, where there is a real public risk, but not for a bookkeeper. Alternatively, some requirements could be reduced such as the very expensive premises investment required to meet health and safety requirements, wherever they have a marginal effect on health and safety. This approach should especially benefit women whose micro-enterprises (particularly in beauty, childcare and catering) are disproportionately highly regulated.

## Tax and welfare policies

### Extend eligibility for support

One reason that people are not able to transition into the mainstream is that, despite a number of initiatives such as Working Tax Credit, government policy is still too focused on supporting people 'in need' as opposed to helping them to graduate out of need. The eligibility criteria for public support should therefore be extended to the zone which lies between the upper margin of poverty (ie. the current levels) and the lower margin of eligibility for mainstream business and financial services, in order to incentivise and fully bridge the transition for people to cross into the mainstream.

### Base policies and programmes on three essential principles:

> Covering the cost of living
> Building savings/reserves
> Increasing business net income

Any scheme that provides effective transition support for people to graduate from welfare to self-employment needs to take into consideration the fact that a person is unlikely to attempt the transition unless, firstly, they are sure that they can cover their cost of living, whatever the consequences of their business start-up efforts; and secondly, they have a savings/reserve 'rainy day' fund to fall back on in the event of cashflow difficulties. Once these two pre-requisites have been covered, they will then be able to focus on increasing their business net income. These three objectives should therefore be the key elements or building blocks of an effective welfare-to-self-employment transition scheme, rather than the current focus on the third element only.

### Increase carrots vs. sticks

Despite a number of government schemes such as New Deal, the current emphasis in the design of these programmes is still heavily weighted towards 'sticks' rather than a more even balance of 'sticks' and 'carrots'. If these programmes are to achieve better results, greater sensitivity should be built into the motivational impact of the rules on the target population. This should expand the take-up or use of the programmes by those who will truly benefit from them and for whom they were intended. For example, a defined period of guaranteed cost of living support would provide a 'nothing to lose' incentive to starting and developing a business. Programmes also need to re-balance the emphasis towards optimising the benefit from usage, as opposed to the current focus on minimising non-abuse (and thus failing to achieve the desired take-up rates and intended impact).

### Streamline benefits thresholds

At present, there are a number of benefits rules which 'force' distortions in people's behaviour. These are created by putting simple caps on permitted 'earnings disregards' (59), work hours or savings levels for benefits eligibility, as opposed to a graduated approach. For example, if working more than 16 hours a week disqualifies a person for Jobseekers Allowance, they will not be able to transition to 17 hours or more without suffering

(59) 'Earnings disregards' are the earnings people are permitted to receive and still keep their benefits.

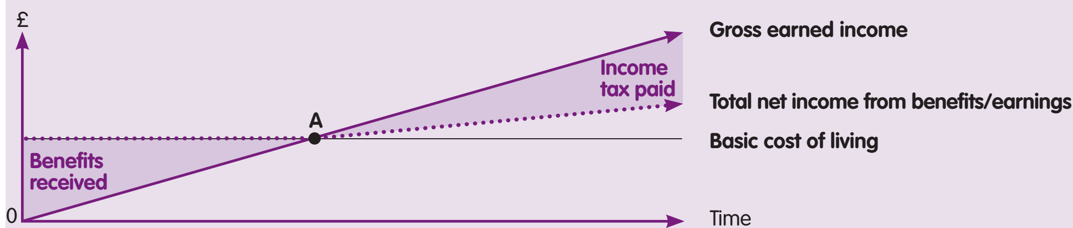
major financial consequences. What is needed instead is a sliding-scale system which encourages people to work, earn and save as much as they can, rather than manage down their capacity to become independent of state support in order to fit into the current benefits rules.

### Coordinate tax and benefits

The lack of an effective welfare-to-self-employment transition mechanism is partly caused by the separate functioning of the Inland Revenue and the Department for Work and Pensions. This means that tax and benefits thresholds are not as seamless as they should be. In reality, people need to be able to graduate from receiving benefits, to progressing through a 'no benefits, no tax' point, to becoming a tax payer (see first diagram below). This will eliminate some current anomalies in which people's benefits are stopped too soon and/or inappropriately taxed away (see second diagram).

**Theory**

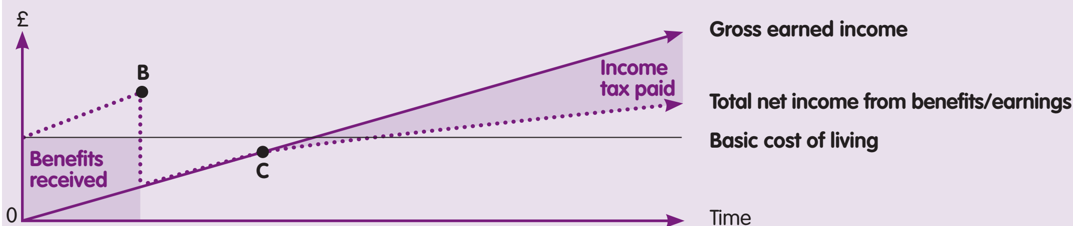
**An individual's seamless progression from benefits recipient to tax payer**




A: Point at which state benefits are no longer needed but income tax is not yet affordable

**Practice**

**The problem of building the business when state benefits stop and/or tax liability starts before the business is able to cover the family's basic cost of living**




B: Maximum permitted earnings before benefits stop
C: Maximum permitted earnings before tax credits/exemptions stop

### Increase beneficiary control

Because individuals have completely different risk tolerances, a 'one size fits all' transition policy is unlikely to give them the precise amount of support that they require. A system should therefore be designed to give benefits recipients as much control as possible to determine their own timing of when they switch from state support to business income.

This could be achieved by means of a modification of the test trading dual bank account system operated by organisations such as InBiz. The proposed modification is described at the top of the next page.

## Dual Bank Account System

### for streamlining the welfare-to-self-employment transition process

| | Benefits Account | | Business Account | |
|---|---|---|---|---|
| Income | Welfare benefits | eg. £10,000 | Business revenue | e.g.£24,000 |
| Expenses | Living costs | eg. £10,000 | Business expenses | e.g.£12,000 |
| Net balance | | £0 | Net Balance | £12,000 |

**Individuals each have two bank or credit union accounts, but can only access one at a time, i.e. the Benefits Account only until they decide to switch to the Business Account, at which point the Benefits Account is closed.**

**Individuals each receive welfare benefits for a maximum period, which pays for their living costs. During this time they can make a one-time switch to access the business account, (with a £12,000 net balance in this example), out of which the living costs (of £10,000 in this example) must be paid. This leaves a net balance of £2,000 which, depending on their risk profile, may or may not be enough to give them the level of security needed to be able to make the switch.**

**Given that everyone is different, this scheme would allow individuals to each make the switch in their own time but, once made, not be able to revert back to benefits for a minimum period. If the business did not make enough during the allowable period to make the individuals wish to switch account, the balance in the Business Account would then be forfeited (ie. be credited back to the government) and the participants in the scheme would be no worse off than before they started, as they would have kept the security of their benefits at all times as well as gained some valuable experience. They could potentially then have a second chance with another new business.**

## Over-indebtedness & savings

With over £1 trillion now owed in household debt (double the 1997 figure), equating to £16,700 for every man, woman and child, and as many as 1 in 20 households now using up more than a quarter of their income on consumer credit repayments alone, debt has become an extremely serious problem for many people in the UK. For those on low incomes, in particular, it is a very expensive necessity, with extremely damaging consequences if the borrower cannot repay the scheduled amounts and the capital amount owed escalates out of control. Despite the recent measures announced by the Dti in June 2004 (60), further steps still need to be taken to tighten the Consumer Credit Act, including the reinstatement of a variable ceiling on lending rates by loan companies and banks (61).

As regards savings, there are not only no positive incentives to save but there are a number of disincentives, such as a savings cap on eligibility for certain state benefits. Not only do these need to be removed, but strong positive incentives are also needed to restore a culture of savings. These could include a national roll-out of the Savings Gateway scheme and other financial literacy initiatives, as well as the introduction of new, affordable financial planning services.

(60) The Dti published a Consumer Credit White Paper in December 2003 to “Minimise the number of consumers who become indebted and improve the support and processes for those who have fallen into debt”. Since then, three working groups have been created to develop a strategy and action plan. This has resulted in a new white paper, “Establishing a transparent market: Government’s consultation response”.
(61) The ceiling on legal lending rates in the UK was abolished in 1974. For a reinstatement of such a ceiling to work, it may need to be accompanied by a proportionate increase in the availability of affordable credit, eg. from CDFIs or Credit Unions. Otherwise, expensive legal money lenders may simply be replaced by illegal loan sharks. In Germany, however, this did not happen. After interest rates were capped at about 20% p.a. in the early 1980’s, there followed a massive increase in consumer credit within the limits. This meant that many poor people were able to access mainstream credit for the first time.

# Micro-finance organisation issues

## Definition of charity

Low income micro-entrepreneurs exist in a 'no man's land' between business and charity, in the sense that they are not looking for, nor do they need 'hand-outs', but neither are they eligible for many types of mainstream services. Because of their 'borderline' status within the definition of permitted charitable beneficiary and because of the commercial-seeming nature of micro-finance, Street UK had great difficulty in obtaining a charitable registration for its activities (62). Since that time, however, the Charity Commission has supported the inclusion of the Prevention of Poverty (as well as the alleviation of poverty) as one of the new heads of charity to be approved in the Charities Bill 2004 (63).

Not only is it critical that this legislation be passed, but also that the underlying point be understood: namely, that "self-help" and "charity" are not diametrically opposed to each other such that, if a person does something for him-/her-self, (s)he cannot by definition be a recipient of charity. An unemployed person may need a large amount of external support but can still manage to do something for him- or her- self. Similarly, an employed or self-employed person with a lower than subsistence income, though mostly self-reliant, still needs some external support. If the objective is to encourage people to do as much as possible for themselves, then 'gap-filling' support should be eligible for charitable status as a matter of course.

## Not-for-profit legal entity

At an institutional level, the same issue applies for micro-finance organisations as for micro-entrepreneurs. They are commercial to the extent that they trade in financial services, but non-commercial to the extent that their objective is not profit-maximisation. In the USA, a 501(c)3 vehicle exists for such 'social enterprises', allowing them to trade and receive tax exemptions as long as they reinvest their profits. The proposed CIC (Community Interest Company) in Britain, adapted from the 501(c)3, includes the ability to trade and the restrictions on profit distribution, but lacks the tax exemptions. It is, therefore, doubtful that it will be as effective in providing a useful 'middle-ground' legal entity because of the difficulty in raising equity capital without either the capacity to give the investor a suitable return or tax relief for their charitable support. A graduated approach is proposed instead, whereby CICs could raise equity through a spectrum of options, ranging from more commercial (ie. offering a higher return to investors but no tax benefits) to more philanthropic (offering a low or no return but full tax benefits).

## CDFI regulatory framework

The current regulatory framework for financial institutions is heavily (and necessarily) focused on the *safety* of the financial system. For this reason, not-for-profit organisations such as credit unions and community finance organisations, which have over-arching objectives of *widening access to financial services*, (in part by making them affordable, which of course impinges on their financial strength), may well need their own regulatory framework, especially designed for non- profit-maximising financial institutions or community banks. In particular, this would enable them to take deposits to a greater extent and substantially improve the culture of savings in the UK (64).

A safely tiered deposit-taking regulatory framework, offering a number of options to community finance organisations, depending on their management experience, capital base, lending track record, etc., would enable a variety of models to operate, ranging from pure loan funds (ie. not involving depositors' funds at all) to credit unions (involving members' deposits only) to fully licenced deposit-taking, insurance provision, etc. Internationally, this kind of regulation is known as para-banking. There are a number of countries where regulatory reforms have already been introduced, creating useful precedents and working models around the world (65).

(62) This was a critical requirement in order for Street UK to be able to access major categories of donations.
(63) The draft legislation for this Bill is currently being reviewed by the Parliamentary Pre-Legislative Scrutiny Committee.
(64) This would not compete with commercial bank savings as it would be focused on creating new savings and on bringing existing 'mattress money' into the formal financial system'.
(65) South Africa, Peru and Bosnia all have para-banking regulations.

In the UK, a review of the current regulatory framework is recommended in order to determine the precise changes needed and whether or not they merit a separate framework for deposit-taking community finance organisations.

The kind of licence that micro-finance banks need includes the ability to take client deposits and make loans without the restrictions imposed on e.g. credit unions or mutual credit societies (66). If such a licence were to be created, a number of measures could be taken to protect the health and safety of the micro-finance industry, including:

> A lower cap on the micro-finance institution's capital: asset ratio than mainstream banks and a graduation policy such that, for brand new organisations it is lowest and then rises with the track record of consecutive years' lending with a minimum repayment rate.

> Separate ratio requirements in relation to client deposits (only) vs. total risk assets, based on the size and track record of the organisation.

> Deposit protection through the Financial Services Compensation Scheme for clients of micro-finance organisations, or a separate scheme with similar protection.

> An industry-specific set of institutional risk assessment measures.

> Standardised definitions of e.g. delinquencies, defaults, operating and financial sustainability.

> Standardised performance measures to compare, e.g. asset quality or operating efficiency between different institutions.

## Enforcement of minimum bank investment

In the USA, the Community Reinvestment Act (CRA) was passed for the purpose of ensuring that commercial banks provide a minimum level of financial support to disadvantaged communities either directly or through CDFIs. US community finance practitioners are generally agreed that this has been the single most important driver of investment in financially excluded communities, as well as the most important factor in their own ability to continue their work. In the UK, the idea was proposed and rejected, with the result that there is generally a low level of voluntary support from banks. Without some form of compulsory measure, not least to protect well-intentioned banks from competitive disadvantage, it is unlikely that a minimum level of overall investment in unbanked communities can be assured.

## Tax policies for investors

In the UK, the Community Investment Tax Relief (CITR) has been introduced to provide an incentive to individual and institutional investors that are interested in placing their funds into CDFIs that on-lend to enterprises in disadvantaged areas. This is adapted from a similar scheme in the USA which has been running effectively for several years (67). However, the CITR rules are more restrictive than their US equivalents and may need to be made more flexible, if the take-up rates are to become significant. Street UK, for example, has not been able to benefit directly from CITR because of the restrictions on the permitted timetable of funding drawdowns. This and other problems experienced by CDFIs are currently being raised by the CDFA with the government.

## Incentives for further commercial and non-commercial investment

There are a number of additional measures that government could take to incentivise further investment into CDFIs. These can generally be classified into measures which enhance the investors' return, and measures which reduce their risk.

(66) These may include lending caps for each client, set in relation to their deposits rather than to their business needs or cashflow capacity.
(67) This is the New Markets Tax Credit, which is a 39% tax credit for investors in commercial projects located in qualifying low-income census tracts. The credit was created in 2000 by the US federal government to help stimulate $15 billion in new capital for low-income communities over the next 7 years. See www.cdfifund.gov/programs/nmtc.

### Return-enhancing measures – tax credits or grants

In addition to the tax incentives described above, a grant scheme for institutional wholesale investors in CDFIs would be very helpful. In the USA, a government programme known as the Bank Enterprise Award Scheme has been successfully operating for some time, to incentive investment by commercial banks into CDFIs. Because the grant amount is calculated in relation to the capital amount lent, it incentivises both good performance and growth by CDFIs. Street UK believes that some form of Bank Enterprise Award, which is also available to charitable trusts and foundations, in order to encourage mission-related investments from their endowment capital, would have a significant positive impact on the levels of investment capital available to the CDFI sector.

### Risk-reducing measures – guarantees or deposit insurance

At present, the main UK government programme for reducing the risk inherent in small business lending (and therefore in the credit risk for wholesale organisations investing in retail lenders to small businesses) is the Small Firms Loan Guarantee Scheme (68). Over the past years, this has been under-utilised, largely because of the number of restrictions on eligibility. Street UK recommends that at least a portion of this fund be reallocated to CDFIs:

> To support their lending to micro- as well as small businesses, social enterprises and low-income individuals, and cover every kind of business or trade, and loan purpose.

> To provide wholesale guarantee support for its loan portfolio rather than individual guarantees for each CDFI client. This would both reduce the administration and diversify the risk.

Alternatively, and possibly better still, the fund could provide loan guarantee support to commercial banks which lend to, or invest in, CDFIs along the lines of the US Capital Access Program. This scheme is interesting not only because it incentivises high loan repayment rates, but also because it uses relatively little public funding in relation to the loan amounts guaranteed (69).

For some commercial banks, a better alternative than a loan could be to place a deposit with the CDFI. Since deposit rates are lower than lending rates, this would help to reduce the interest rate payable by the CDFI. The Financial Services Authority's permission would be required to ensure that this is not considered a 'deposit taking activity' by a CDFI without a deposit-taking licence. The government's role would then be to provide its risk-reducing support to the commercial bank in the form of deposit insurance.

## Government organisational issues

## Re-defining objectives and desired outputs

If government is to be effective in providing the appropriate support for micro-entrepreneurs, a number of its objectives and targets need to be adjusted. For example, when supporting employment creation programmes, government targets only measure or focus on jobs created and the start-up of new businesses. Street UK recommends that a gradual increase in people's work hours as they move to full-time self-employment be recognised as a valuable output. Given the high business failure rate relative to the new business start-up rate, protecting businesses from failure needs to be at least as valid a contribution as supporting their start-up development.

In relation to the informal economy, an understanding is needed of its significant positive value in giving to individuals crucial, otherwise unavailable transitional support, and to communities, assistance in enabling them to help others up the ladder on an affordable basis. This should be reflected in a subtle but nevertheless critical change in the government's objective, from its current stance of eliminating the grey market, to one of providing sufficient practical opportunities for people to graduate out of it.

---

(68)The Small Firms Loan Guarantee Scheme principally provides commercial banks with 75% guarantee support on 2-10 year loans of between £5,000 and £250,000,

(69) Under the Capital Access Program, three parties contribute to the loan loss reserve: the lender, i.e. commercial bank; the government which match-funds the amount reserved by the lender; and the (CDFI) borrower which usually contributes a smaller percentage. This encourages banks to act conservatively i.e. to reserve more and also 'incentivises' the borrower to participate to the extent possible. All amounts guaranteed by the government to a given lender are pooled i.e. are usable by the lender to cover whatever losses are incurred. As a result of this system, the typical percentage of a single loan to a small business that has needed to be guaranteed by the government is only 4%.

## Creating multi-pronged solutions through joined-up government

In general, the issues facing micro-entrepreneurs are complex and caused by a large number of different kinds of problems. Addressing these problems requires a truly joined-up effort by different government departments. The Social Exclusion Unit was originally set-up to support this objective. Because it is an advisory unit, however, rather than a Spending department, its powers are limited to the coordination of inter-departmental collaboration. More support is needed from the Cabinet Office and Treasury if the organisational structure and mainstream budgets of government are to truly respond to those issues which are complex and require multi-departmental support. The table below shows the main departments and agencies which each address an aspect of the issues affecting micro-entrepreneurs.

**Areas of government relevant to micro-finance**

| Government department / agency | Relevant issue |
|---|---|
| HM treasury | Financial inclusion |
| Dept. of Work & Pensions | Welfare to self-employment support |
| Dept. for Education & Skills | Employment and skills |
| Dept. of Trade & Industry / Small Business Service | Business and financial services for micro-enterprises |
| Dept. for Environment, Transport & Regions | Deprived area regeneration |
| ODPM's Social Exclusion & Neighbourhood Renewal Units | Social / economic inclusion in deprived areas |
| Home Office / Active Communities Unit | Micro-entrepreneurs as 'community' social-entrepreneurs |
| Inland Revenue | Tax issues particularly re: informal economy |
| Financial services | Financial literacy |
| Charity Commission | Regulatory issues for community finance charities |

## Linking department / agency databases

The current separation between the Inland Revenue and the Benefits Agencies means that it is relatively easy for people to miss out on or be delayed in receiving state benefits, such as tax credits or housing benefit run-on, as well as to cheat the system. Both practices would be significantly reduced if the data systems used by the various agencies and/or government departments were further linked, e.g. showing a person's situation and therefore eligibility for housing benefit, child benefit, working tax credit and taxable income and/or taxes paid.

An additional advantage of greater database unification is that it would facilitate the recommendation made earlier in this Chapter for greater tax and benefits coordination. A system which can monitor and track the transition people make from benefits into work could respond immediately to changes and keep the right balance between benefits and tax. This would lead to a more precise assurance of the appropriate level of net income for the individual.

Clearly there are data protection and privacy issues that need to be taken into consideration (70). However, this is still an important issue which Street UK believes should be reviewed, not least because it is the *combination of support measures* (cutting taxes, increasing benefits and cutting red tape) and *enforcement measures* for the remaining rules and restrictions, that is recommended in this paper, not the support measures alone.

(70) The merger of the Inland Revenue and Customs & Excise should help this process.

# Increasing role of voluntary sector

There are many instances in which voluntary and community organisations are more suited than public agencies to providing a particular service. This is not only because they tend to work directly with people on the ground, at a grass roots level, but also because they are independent of government and therefore able to be closer to the people they are helping.

Greater involvement and influence on the *design* of services by community organisations is therefore recommended. This should lead to increased efficiency and effectiveness in the way public resources are spent and used, as well as better value for money. Support is also needed to increase community organisations' ability to tender for the *delivery* of local services. For this to be possible, they must be able to tender on a more comparable basis to public sector contractors, i.e. obtain longer term contracts (e.g. 1 – 3 yrs) than are currently generally offered to them, and also charge for their services on a full cost, rather than marginal cost recovery basis.

In certain instances, community organisations should also be given discretion to determine the precise level of welfare benefits for individual beneficiaries, within pre-set bands. This would help micro-entrepreneurs in transition between welfare and self-employment, for example, to receive graduated support as they progress, based on the community organisation's detailed knowledge of their situation.

# Chapter 7

## Areas for further research
## Lessons still to be learned

**After only a few years of operations, there is still much more for Street UK, and the micro-finance sector in general, to learn. This final chapter tries to capture in the form of a table the key areas that need to be either researched or piloted.**

These are shown on the next two pages, classified a) by generic category, ie. whether they are related to the business development aspects of micro-enterprises, or to the financial services issues for micro-entrepreneurs and other low income individuals; and b) by perspective on each category, including the size and nature of the client market, creating a tailored product / service, organisational development, regulatory issues and impact assessment.

**It is hoped that this framework will provide a useful mechanism for reviewing ongoing progress in filling the current knowledge gaps.**

# Key knowledge gaps

| | Issues specific to micro-enterprises |
|---|---|
| | **Business-related** |
| **Size of client market** | Size of the informal 'grey' economy of low income, self-employed people. |
| **Nature of client market** | Positive functions of the informal economy including its contribution to income-generation, employment and skill development amongst low-income groups. |
| **Product/services required** | An analysis of gaps in the range of business development products and services required by micro-entrepreneurs, ie. between consumer services and services currently available for the smallest of businesses. (See Chapter 6 for examples). |
| **Business development issues for (CDFI) providers** | In order to address the widespread problem of client volume, an analysis of the ways in which micro-entrepreneurs are currently being reached vs. potential alternative marketing routes, including a better understanding of whom they talk to, where they seek advice and where they find useful information. |
| **Suitable organisational models for delivery** | A comparison of the different organisational models of existing UK micro-finance organisations, with specific regard to geographic outreach, cost-efficiencies and economies of scale, including a comparison of stand-alone organisations with different forms of partnerships, sub-contracting agreements and franchise arrangements. |
| **Regulatory issues** | Other countries' approaches to their own informal economies. Strategies to help UK micro-entrepreneurs to graduate out of informal activities into fully regulated small businesses. Policy changes particularly in the respect of small business red tape and regulatory requirements, to make them reasonable and manageable for micro-businesses. |
| **Impact assessment / measures** | A comparison of the key (social, economic and financial) impacts that micro-finance organisations believe their work is making vs. the impact measures that funders (particularly from the public sector) ask them to report or deliver, together with an analysis of the consequences of any differences between these two, especially with regard to undesirable distortions in the organisations' operations. |

## Issues generic to low-income individuals (including micro-entrepreneurs) who cannot access mainstream financial services

| Debt-related | Savings, Insurance, Financial Planning-related |
| --- | --- |
| Size of the market of micro-entrepreneurs unable to access mainstream business credit. | Scale of the unmet demand for appropriate, tailored savings, insurance and financial planning products. |
| Factors behind certain customer groups having a worse credit rating from a bank perspective and ways to address these. | Deeper understanding of how poor people currently or potentially could save, insure themselves and plan their finances (including barriers / limits), beyond the specific evaluation of the Savings Gateway pilots currently underway. |
| The most inappropriate terms and conditions of mainstream loan finance that lead to indebtedness, predatory remortgaging and asset stripping. Product parameter changes needed to reverse these impacts and provide an appropriate lending product. | Gaps in the range of currently available savings, insurance and financial planning products and services, including ways of introducing a version of Ireland's successful Money Advice and Budgeting Service to the UK. |
| Marketing: Strategies and approaches for micro-finance organisations to compete with attractively packaged but inappropriate finance from money lenders, credit card companies, instalment finance.<br>Delinquency management: The causes of loan defaults, a classification of patterns of delinquency with different kinds of borrowers and an understanding of the lessons of collection, e.g. the effectiveness of the court process vs. other methods. | |
| Alternative institutional models for the generic provision of financial services to communities not served by mainstream institutions, including the creation of deposit-taking community banks, and partnerships of mainstream banks or insurance companies and community finance organisations to offer appropriately tailored savings, loans and insurance products.<br>Potential business models for private sector institutions and individuals to benefit from the work of community finance organisations, and therefore be able to support them from their business (vs. community affairs) budgets, in return for value provided, enabling sustainable / self-funded partnerships to be created. | Alternative institutional models for the generic provision of financial services to communities not served by mainstream institutions, including the creation of deposit-taking community banks, and partnerships of mainstream banks or insurance companies and community finance organisations to offer appropriately tailored savings, loans and insurance products.<br>Potential business models for private sector institutions and individuals to benefit from the work of community finance organisations, and therefore be able to support them from their business (vs. community affairs) budgets, in return for value provided, enabling sustainable / self-funded partnerships to be created. |
| Evidence for the need for further tightening of the Consumer Credit Act, specifically in relation to a cap on interest rates.<br>Analysis of the levels of bank investments in CDFIs and under-invested communities in the UK and USA, comparing results of a mandatory vs. voluntary community reinvestment approach, and the case for an equivalent of the Community Reinvestment Act in the UK. | Changes needed to the current Financial Services Authority regulations to enable micro-/community finance organisations to provide the services their clients need, e.g. through deposit-taking, financial advice or insurance brokerage services.<br>Evidence that asset-building is a crucial element to graduating out of poverty, making the case for key US asset-building strategies to be introduced into the UK. |
| A comparison of the key (social, economic and financial) impacts that micro-finance organisations believe their work is making vs. the impact measures that funders (particularly from the public sector) ask them to report or deliver, together with an analysis of the consequences of any differences between these two, especially with regard to undesirable distortions in the organisations' operations. | A comparison of the key (social, economic and financial) impacts that micro-finance organisations believe their work is making vs. the impact measures that funders (particularly from the public sector) ask them to report or deliver, together with an analysis of the consequences of any differences between these two, especially with regard to undesirable distortions in the organisations' operations. |

COFFEE HOUSE

WE HANDMAKE ALL OUR GOURMET
THE FINEST NATURAL INGREDIENTS & FREE RANGE MEATS
BAKED FRESH HERE EACH DAY, THEYRE GREAT WITH OUR FRESH

© Copyright 2004 Street UK and Rosalind Copisarow.
All rights reserved.

Publisher: Street(UK) Foundation.

This publication may not be reproduced, stored in a retrieval system or transmitted in any form, or by any means (electronic, mechanical or otherwise) without the advance consent, in writing, of both the copyright owner and the publisher. However brief extracts may be reproduced for non-commercial or training purposes provided the source is acknowledged and the publisher informed.

A British Library CIP record is available for this publication.

ISBN 0 9549499 0 0

Further copies of this report can be obtained from:
Street UK
Studio 12, Style Works,
50-54 St Paul's Square,
Birmingham, B3 1QS

T: 0121 230 1060, F: 0121 230 1061
E: info@street-uk.com, www.street-uk.com

Parent company: Street(UK) Foundation,
Registered Charity no. 10811902, Company no. 3909272.
100% Subsidiary: Street(UK) Ltd, Company no. 3832332.

Photos: Julianne McGunnigle
Design: Heat Design, www.heatdesign.com
Printing: Special Blue, 30 Cranwell Close, Violet Road,
London, E3 3QY

**streetUK**
**micro-finance**

Street UK
Studio 12, Style Works,
50-54 St Paul's Square,
Birmingham, B3 1QS

T: 0121 230 1060
F: 0121 230 1061
E: info@street-uk.com
www.street-uk.com

CALOUSTE
GULBENKIAN
FOUNDATION

EUROPEAN MICROFINANCE
network

The production of this document has been part- funded thanks to the support of the European Commissions' Community Action Programme to Combat Social Exclusion 2002-2006