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13 August 2010

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Please find written evidence to the BIS Committee Inquiry into Local Enterprise Partnerships (LEPs) submitted by the Community Development Finance Association (**cdfa**).

The **cdfa** is the trade association for Community Development Finance Institutions (CDFIs) in the UK. CDFIs provide credit and financial services to markets that are underserved by the mainstream commercial finance sector. In the UK, CDFIs serve three main markets:

- micro, small and medium enterprises;
- social enterprises; and
- individuals who are financially excluded.

This submission highlights the need for LEPs to provide sustained and consistent support to CDFIs so they can address market failure in the provision of business finance.

For enquiries about the submission please contact:

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We would be happy to give oral evidence to the committee, and for the contents of our written submission to be put in the public domain by BIS.

Yours faithfully

A handwritten signature in black ink that reads 'Bernie Morgan'. The signature is written in a cursive, flowing style.

Bernie Morgan  
Chief Executive

## Memorandum

To: Business, Innovation and Skills Select Committee

From: Community Development Finance Association

RE: The New Local Enterprise Partnerships

Date: 13 August 2010

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The Community Development Finance Association (**cdfa**) is pleased to respond to the Commons Select Committee on The New Local Enterprise Partnerships.

The **cdfa** is responding on behalf of its 70 members comprised of Community Development Finance Institutions (CDFIs). CDFIs are non-commercial social enterprises which deliver credit and financial service to those in greatest need. CDFIs serve three markets: third sector/social enterprise; micro, small and medium businesses in disadvantaged communities and financially excluded individuals, providing credit where access to finance has been denied by mainstream financial institutions.

Our response has been instructed via direct consultation with our membership.

### Summary of main points

- To be effective, LEPs must have not only a common goal but also an understanding of the need to utilise proven models for delivery at the local level.
- The community finance model espoused by the UK's Community Development Finance Institutions (CDFIs) are recognised as a proven way of delivering business finance to those communities which will be most affected by public spending cuts and which LEPs are being devised to redress.
- CDFIs exist to build entrepreneurship and lasting wealth in and among the UK's disadvantaged communities which are underserved by mainstream financial institutions. CDFIs require commitment to provide concerted and sustained support in order to ensure adequate reach and scope to deliver the aims and objectives of LEPs to rebalance the economy towards the private sector and renewing local economies.
- By recycling money CDFIs provide much greater returns on investment than single-use capital injections can.
- CDFIs must be seen as a primary vehicle to ensuring success of the LEP model.
- Microfinance is the best way to maximise gains in entrepreneurship.
- The need for support for the Big Society should be on every LEP's agenda with representation of social lenders on every LEP board.

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### The functions of the new Local Enterprise Partnerships and ensuring value for money

1. LEPs must conform to a unified, cohesive directive to avoid disjointed, imbalanced results. This is not to say that delivery cannot or must not be at "the local level", however defined, but that there must be an overarching ethos and clear statement of shared goals, executed in a consistent and systematic way. The problems faced by communities suffering from under-investment and a lack of a strong foundation for entrepreneurship are shared across the UK, and therefore it is sensible to devise a model for redressing these problems using a unified and fully-supported approach, delivered locally.

2. LEPs must be empowered to provide the most cost-effective business support solutions, with a particular emphasis on the prime area of market failure in business finance: support to financially excluded, disadvantaged communities and entrepreneurs, defined both geographically (location) and demographically (socio-cultural).
3. Community Development Finance Institutions (CDFIs) are the only practitioners with a proven track record of working in this space. Their expertise and insight into successful delivery models must be recognised and supported. Creating new forms of such service provision will necessarily be time and resource intensive, misdirecting the focus from providing the right kind of support as quickly as possible onto engaging in developing a duplicative and redundant activity. CDFIs are ready to deliver success now.
4. Recognition and support of community finance has not been sustained and remains inconsistent and poorly coordinated. The time is now to develop a national programme delivered locally to expand the scale and reach of tried-and-trusted models for providing financial and ancillary support to businesses. A capacity building programme is required in order to enable existing CDFIs to expand as well as new CDFIs to establish themselves in underserved areas.
5. LEPs need to have a strong understanding of and commitment to microfinance (loans of under £25,000 to business with under 10 staff) if the problems that the LEP system is being created to redress are to be corrected in a sustained and cost-effective way. It is crucial to recognise the importance of microfinance, particularly in light of the banks' market failure in engaging in this type of activity.
6. It is generally recognised that banks have retreated from the market sector served by CDFIs and will be unlikely to return for many years. LEPs can do much to ensure we are a sustainable presence in the future.
7. Whilst certain RDAs appreciated the value of CDFI and microfinance to ensure entrepreneurial success in disadvantaged communities, others did not, as evidenced by the varying degrees of support to CDFIs between RDAs.
8. Given that there will be a diminished capacity and scope in business support as delivered heretofore, CDFIs would make a logical one-stop-shop approach to combining both finance and business advice together. The quality of business prospects is a central factor in lending and the right kind and level of business mentoring and monitoring in the first year of a start-up business could substantially improve the chance of survival.
9. The role of CDFI business finance should be seriously considered as the primary solution. CDFIs must have a seat at the LEP table and be recognised as one of the most important civil society players in this arena, better positioned than the charitable end of the spectrum to deliver sustained outcomes. In addition, CDFIs have a performance framework, designed to encourage confidence among stakeholders and investors.
10. Independent research commissioned by BIS and OTS in March 2010 demonstrated that "...CDFIs are generally efficient vehicles for the delivery of capital to businesses..."<sup>1</sup> and that for each £1 of public expenditure CDFIs create or safeguard £8.57 at the local community level. This does not take into account the role of capital recycling, that capital is repaid and re-lent. Extrapolating from this, it is likely that for each £1 invested into CDFIs an estimated £15 gross value added would be delivered following a three-year lending cycle.

### **The Regional Growth Fund, and funding arrangements under the LEP system**

11. CDFIs have demonstrated great efficiency in converting public grant funding into capital that is used repeatedly, not just once, as is the case when such funding is allocated to a single-time use (see para 10, above). In this respect, CDFIs are perfectly placed to work directly with

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<sup>1</sup> *Evaluation of Community Development Finance Institutions (CDFIs)*, BIS, Cabinet Office, GHK, March 2010. p. 79

capital provided by the Regional Growth Fund, ensuring that finance is delivered to create economic growth and create jobs.

12. The trade body representing the CDFI sector – the Community Development Finance Association (**cdfa**), would serve as a natural conduit in working with the RGF directly in order to disseminate funding to CDFIs.
13. The obvious way to deliver finance to budding and existing small businesses is through a strong relationship between LEPs and CDFIs such that CDFIs continue to be supported both publicly and privately.

#### **Government proposals for ensuring co-ordination of roles between different LEPs**

14. While LEPs must be able to respond to local needs, it is also important that they have a shared, clearly stated remit. Coordination at an organisational level above LEPs would be more effective than devising a system whereby LEPs must co-ordinate amongst themselves. The need for such higher-order coordination is borne out by the disparate results delivered regionally under the previous system, whereby some regions enjoyed the benefits of entrepreneurial support through a community finance model, whilst others focused on less sustainable philanthropic approaches.

#### **Arrangements for co-ordinating regional economic strategy · Structure and accountability of LEPs**

15. Lord Wei, the Government's Big Society advisor, has stated that it is necessary for CDFIs to operate at scale while also delivering tailored and sympathetic services. To achieve the first part of this equation, CDFIs must be supported on a consistent basis by all LEPs.
16. Care must be taken to ensure that economies of scale are supported by localism that is not so parochial as to have no capacity to ensure scale. Commonly shared goals and delivery models must predominate and direct the LEP structure. Scale and size are paramount to efficiency and success.
17. Given that the proposed LEP structure is local, recognition that the predominant CDFI model is also local and has proven that local delivery of business support and finance can be made to work successfully. Care must be taken that the definition of local is not overly small if viability is to be maintained. There is a natural synergy between a local enterprise finance provider and LEP. The two are, quite simply, natural partners, particularly where the CDFI has been operating in the area for a number of years.
18. However, many CDFIs operate at supra-regional levels. A highly localised LEP structure will constrain these providers in their ability to devise and deliver national or multi-regional programmes and operate at scale.
19. There is a risk that that highly-localised LEPs will cause fragmentation of financial service delivery programmes which are more appropriately pitched at a larger geographic scale.

#### **Means of procuring funding from outside bodies (including EU funding) under the new arrangements**

20. Contacts the **cdfa** have had with EU and EC and their agencies suggested that England missed out on a lot of EU funding due to the difficulty of dealing with nine different entities, each with their own, different agendas and approaches. Central administration and relationship-building with European entities is, perhaps, a preferred method of securing funding.
21. LEPs could play a lead role in managing European funding contracts such as ERDF, where available.