

# **Lessons from Experience: An Evaluation of Street (UK)**

**A Report by the New Economics Foundation**

**May 2004**

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## Executive Summary

### Purpose of the Report

In July 2000, the Esmée Fairbairn Foundation approved a grant of £1.3 million to Street (UK). This is one of the largest grants it has ever made. The Foundation is interested in evaluating and learning from this grant. Hence, it commissioned this report by nef (new economics foundation).

The report aims to:

- Provide a review of Street (UK)'s experience and an evaluation of their performance, within the context of the performance of the community development finance sector as a whole.
- Provide an understanding of the challenges Street (UK) has faced during their first three years of operations.
- Synthesize the lessons learned from Street's experience related to their client group, the community development finance sector, grant makers, commercial banks and policy makers
- Make recommendations for action for all stakeholders in the community development finance sector.

### Summary of Street (UK)'s Achievements 2001 – 2004

- Over £600,000 lent to 260 self-employed people and microenterprises in some of the UK's most deprived areas.
- More than 1,000 microentrepreneurs have received practical business advice
- Good repayment performance with a current 83% on-time collection rate and less than 4% write-offs.
- High levels of client satisfaction and impact on business development and personal well-being.
- Helped safeguard at least 50 businesses and created 130 new jobs.
- Well-developed retail lending and business support model in terms of marketing, credit assessment, delinquency management and information systems.
- Start-up of promising wholesale operations to provide information systems and back-office support to other CDFIs.
- Action research and policy work providing a voice for self-employed people in Britain operating in the informal economy or the lower margins of formal business.

### Street (UK)'s History and Business Strategy

Street (UK) was founded in August 1999 to provide loans (microcredit) to self-employed people and very small business not considered creditworthy by banks. Street's original goal was to establish 40 branches serving 20,000 active clients and a £40 million loan portfolio over a seven-year period. This was a very ambitious goal that has proved difficult to achieve. However, despite setbacks, the Board and management of Street have remained committed to their original vision and demonstrated themselves to be a

dynamic, learning organisation able to learn from experience and integrate this into their business strategy.

Street's initial focus was on the provision of microcredit – loans up to an initial loan size of £10,000 and 12 months to businesses with less than 5 employees. Over time, their business model has developed to place a greater focus on the provision of business support (in recognition of the lack of investment-readiness of many of their client group), as well as the development of wholesale services to other CDFIs (an area of comparative advantage with good potential for revenue generation) and policy and advocacy work focused on tackling the obstacles that their client group face and which undermine demand for their services.

## **Lending Results and Financial Performance**

During April 2001 to March 2004, Street (UK) made a total of 259 loans worth £600,000. The total number of current loans outstanding on March 31<sup>st</sup>, 2004 was 148 with a gross loan portfolio of £304,000. Overall, these results are a fraction of what was originally projected. However, despite this, Street is performing as well as other CDFIs serving similar markets.

Client testimonials confirm that there is market gap for financial services among Street's target market, which Street is meeting effectively. However, there is still uncertainty as to the size of this market gap and hence demand for Street's services. Street's, and other CDFIs' experience, suggests that there is a large latent demand, but to turn this into loan-ready business propositions requires tackling issues such as lack of investment-readiness, the UK's easy debt culture and the design of the welfare system.

Street (UK)'s financial performance has been comparable with other CDFIs. After some initial difficulties, they now have high levels of on-time repayment and a write-off rate of 4%. In terms of cost effectiveness, it costs Street about £2.80 to lend a pound (or £4,300 per loan) taking into account the entire costs of their operations. However, this figure also includes the costs of Street's wholesale operations (StreetServe) and policy work (StreetLab), not just lending operations. Costs are lower when one factors out direct lending costs only. In Birmingham, it costs Street a total of £1.60 to lend £1. Sixty percent of this is spent on business support, an area where Street has found their clients need more support than first envisaged.

In terms of financial self-sufficiency, lower than anticipated demand and higher than planned costs of operation mean that Street has had to rethink what's achievable. Currently, it looks as if at best Street will be able to cover 30% of their costs of lending from interest and fee income in the longer term. Diversification of products and services is, therefore, key to Street's future business strategy if they are to achieve greater scale and self-sufficiency.

## Social and Economic Impact

Street (UK) are reaching their target market – self-employed people and very small businesses which have difficulties getting bank credit. Street is also reaching a high proportion of women clients (30% of total) and ethnic minority clients (54%).

Street's clients are extremely satisfied with the quality of Street's services. They are regarded as a "flexible and friendly loan company" who cares about their clients and provides appropriate finance and support.

The impacts of Street's services on their clients are large. They include helping people start-up and grow their business, transition from the informal to formal sector, and improve their credit history. Street's services also often have a impact on people's personal lives helping to boost self-esteem and confidence. Overall, we estimate that Street (UK) has contributed to the safeguarding of at least 50 businesses and the creation of 130 new jobs over the past three years.

## Lessons learned and recommendations for action

The following recommendations for action emerge from the lessons learned from Street's experience:

**Recommendation 1 (to CDFI supporters):** Recognize that services to address lack of financial literacy and investment-readiness are integral to stimulating a larger market of loan-ready microbusinesses. This needs to be factored in to the design of business models. It increases the cost of lending but adds value in terms of business impact. The costs of such support should be separated out and funded as part of a CDFI's activity or delivered by another organisation.

**Recommendation 2 (to CDFIs and business support agencies):** Develop more tailored business aids that enable microentrepreneurs to develop their businesses gradually, with many small but secure steps (e.g. the availability of van rental by the hour, warehouse / storage facilities available in very small units, part time use of equipped business premises, etc.).

**Recommendation 3 (to Government):** Examine policy measures that can build a bridge from welfare-to-work between the social welfare system, the tax and employment system and the financial system.

**Recommendation 4 (to Government, banks and other financial institutions):** Develop more responsible, people-centered regulatory environment for lending that takes into account low-income people's capacity to borrow and eliminates the worst of predatory lending practices.

**Recommendation 5 (to CDFIs):** CDFIs specializing in microcredit should take care when importing foreign microfinance models, ensuring they are adapted to the cultural and economic context of the UK, and starting small-scale, to minimize the investment / cost during the piloting / adaptation phase.

**Recommendation 6 (to CDFIs and the CDFA):** Greater sharing and peer learning should be encouraged among CDFIs to explore and learn from successes and failures in developing viable business models. The CDFA is already playing an important role in this regard through events, such as the annual CDFA conference.

**Recommendation 7 (to CDFIs):** Consider ways of increasing market research and evidence of demand before introducing new products.

**Recommendation 8 (to grant makers):** Consider taking a venture philanthropy approach when investing in start-up and early stage organizations with a sense of shared risk and long-term engagement.

**Recommendation 9 (to grant makers):** Consider co-investing in CDFIs with commercial funders as a way of leveraging grant funds and using their knowledge of good lending practices.

**Recommendation 10 (to grant makers):** Build in an evaluation and learning process during the grant period, particularly for large grants.

**Recommendation 11 (to commercial banks and other financial institutions):** Recognize that the role of the financial sector is to provide financial services to all. Mainstream partnership with CDFIs as part of bank operations at all levels through the activities, such as wholesale funding, client referrals, sharing infrastructure and systems, providing training, technical expertise and staff to CDFIs, partnering on new product development and developing commercial banks products that are appropriate for the financially excluded.

**Recommendation 12 (to government):** Continue investment in a dedicated CDFI fund for at least 5 more years, while encouraging regional and local government to support CDFIs.

**Recommendation 13 (to government):** Broaden the remit of the Phoenix Fund to provide financing to tackling financial exclusion generally, not just enterprise finance.

**Recommendation 14 (to government):** Making mainstream business support more relevant for microentrepreneurs.

# 1. Introduction

## 1.1 Background

Esmée Fairbairn Foundation, one of the UK's largest independent grantmaking foundations, makes grants to organizations which aim to improve the quality of life of people and communities in the UK. It likes to consider work which others may find hard to fund, perhaps because it breaks new ground, appears too risky, requires core funding or needs a more unusual form of finance, such as a loan.

During 1999, Rosalind Copisarow of Street (UK) put forward a proposal to the Foundation. It was an innovative and ambitious proposal that aimed to tackle the needs of very small businesses which have no more than five employees and which are unable to obtain appropriate business finance. It recognized the benefits and dignity of enterprise at a human scale and the opportunities of self-employment for tackling poverty and social exclusion.

Street (UK)'s goal was to create a national institution to support poor, financially excluded microentrepreneurs by providing them with small loans (microcredits) to help secure and develop their incomes from self-employment. They proposed using a group lending mechanism as a means of both securing the loans and providing client businesses with mutual support networks. They also proposed a three regional hub initial branch structure for the pilots, in anticipation of their future national coverage.

In July 2000, Esmée Fairbairn approved a grant of £1.329 million to Street (UK). This is Esmée Fairbairn's largest grant to a community development finance institution (CDFI) and a very large grant by overall Esmée standards (the Foundation has only ever made six grants over £1 million). However, what appealed to the Foundation was the prospect of supporting an institution that would operate at scale and have a major impact, helping thousands of people rather than hundreds.

The Foundation recognized that they were taking a risk making such a large grant for an untested proposal. Hence, the stated purpose of the grant was to enable Street (UK) to operate a *pilot* 'micro finance' programme in three locations between November 2000 and November 2002<sup>1</sup>, as a precursor to a post-pilot roll-out of Street UK's services. The pilot aimed to *demonstrate the demand for micro-credits* (defined as business loans for microenterprises) and *establish the viability of creating a permanent, self-sustaining nationwide microfinance institution*.

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<sup>1</sup> The period of the grant was later extended.

The proposed benefits of the proposal were described by Street (UK) as:

- “Supporting a scheme that would help people help themselves – providing “a hand-up, not a hand-out”.
- Supporting people who are currently beneficiaries of Esmée Fairbairn supported grant schemes through the ‘glass ceiling’ of grant dependency to financial independency.
- Helping hundreds of thousands of people and develop a permanent organisation which can support an unlimited number of future applicants.
- Supporting an organisation that would set an example and become self-sustaining within 6 years.”

## 1.2 Purpose of this Report

As one of Street (UK)’s core funders, Esmée Fairbairn is interested in gaining a better understanding of Street’s experience, the lessons learnt and the implications this has for Street’s future and the future of the community development finance sector. Hence, it has commissioned this report.

The report sets out to achieve four main objectives:

- To provide a review of Street (UK)’s experience and an evaluation of their performance, within the context of the performance of other community development finance institutions (CDFIs) and the sector as a whole;
- To provide an understanding of the challenges Street (UK) has faced during their first three years of operations, the lessons learned and implications for Street’s future strategy and business model.
- To draw out the wider lessons learned from Street’s experience and their implications for Street’s client group, the CDFI sector, grant makers, commercial banks and policy makers.
- To make recommendations for action for all stakeholders in the community development finance sector.

The report findings are based on a review of Street (UK)’s key documents (including Board meeting minutes, quarterly reports, annual reviews, portfolio reports, management accounts, audited accounts and internal memoranda); in-depth interviews with senior management, staff and Board members; semi-structured interviews with nine clients (five based in Birmingham and four in Newcastle); and interviews with others who were felt could offer an outside perspective on various aspects of Street (UK)’s operations.

**nef** would like to thank all those interviewed for their time and valuable insights. Particular thanks to Street (UK)’s directors, Rosalind Copisarow and Martin Hockley, for their time spent with the evaluation team and their openness and responsiveness to providing data and answering questions. A full list of interviewees is provided in Appendix 1.

## Structure of the Report

This report is divided into five more sections:

- Section 2 provides an overview of Street (UK)'s history and business development strategy, including their target market, products and services and business model.
- Section 3 analyses Street's results, including their lending and financial performance.
- Section 4 looks at the social and economic impact and influence of Street's activities at three levels – the clients, the CDFI sector and government policy in relation to self-employment and community development finance.
- Section 5 synthesizes the lessons learnt from Street (UK)'s experience, particularly lessons for other CDFIs serving similar client groups, for funders (both philanthropic funders and commercial banks) and government policy makers, and makes recommendations for action.

## 2. Street (UK)'s History, Vision and Business Strategy

### Introduction

This section provides an overview of Street's history, target market, products and services, and business model. It highlights what differentiated Street from other organizations providing business finance and support services at the time of their start-up and the development of Street's business model.

### 2.2 History of Street (UK)

Street (UK) was founded in August 1999 by Rosalind Copisarow and Martin Hockly. These two brought together an impressive and complementary set of experience and skills. Rosalind is a former investment banker who came to the UK from Poland where she had established a very successful national microfinance institution, Fundusz Mikro, which within five years of operations was serving 15,000 clients and had achieved financial self-sufficiency. She had also been a leading player in the international microfinance sector, serving on the advisory board of the Consultative Group to Assist the Poorest (CGAP), a multi-donor institution promoting micro finance best practice. Martin brought over 10 years management and operational experience with Industrial and Common Ownership Finance (ICOF), a leading lender to cooperatives and social businesses in the UK. ICOF was also the only sustainable lender to micro-enterprises in the UK with its operating costs covered 50% by client loan income and 50% by investment income. Prior to ICOF Martin set-up and ran a number of micro-enterprises himself.

### Street (UK)'s founders were disturbed by the trends they saw in Britain, which they described as:<sup>2</sup>

- “the growing gap between those in well-paid employment and the low paid and unemployed, the ‘haves’ and ‘have nots’ in our society.
- the growing number of people for whom self-employment is the only alternative to unemployment; and
- the impact of the restructuring of the UK financial services industry leading to less availability of trust-based, appropriately structured, small business loans”.

Evidence supports Street's observations. Self-employment is an increasingly important source of employment. In 2002, the self-employed and sole proprietorships accounted for over 10% of all registered businesses in the UK. In the West Midlands, one of Street (UK)'s main areas of operations, self-employment is growing faster than any other type of business at a rate of 7.6% in 1999-2001. Doing something to address these negative trends provided the driving force and rationale for setting up Street (UK).

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<sup>2</sup> Quotes from Street (UK) proposal to Esmee Fairbairn Foundation, July 2000.

## 2.3 Vision and Mission

Street's founders and supporters are motivated by a vision of the UK as "a society in which everyone has access to appropriate business capital; where innovation and initiative are encouraged; where self-help and independence is promoted and where mutual trust and support within communities is rebuilt".

Their mission is "to help poor, financially excluded microentrepreneurs who wish to help themselves". This mission was to be achieved by creating a "permanent, self-sustaining, nation-wide microfinance institution" providing "reliable access to microcredits microentrepreneurs need to secure and develop their incomes from self-employment".

Street's original aim was to create a national institution with 40 branches serving 20,000 active clients and a £40 million loan portfolio over a 7 year period. This was an ambitious goal which has proved difficult to achieve. However, despite many setbacks the Board and management of Street have remained committed to their original vision. Over the last three years, Street has proved itself to be a dynamic, learning organization continually learning from and adapting to the challenges of implementation (including poor lending results, funding difficulties and staffing difficulties) and making changes to their business strategy as a result. This reports sets out to examine Street's experience and performance and the lessons learned along the way.

## 2.4 Target Market

Street (UK) set out to serve a new and underserved niche market – microenterprises, particularly the self-employed and low-income entrepreneurs – with appropriate business finance and support<sup>3</sup>. Street's target clientele fall into three categories:

Microenterprises in the formal economy (expected to be 10% of total clients)

- Businesses that are either too small or too risky for mainstream banks to lend to.

Self-employed grey market activities (approximately 80% of total)

- Those who refrain from declaring the whole of their income to the Inland Revenue, or are trading while in receipt of welfare benefits.

Post start-ups (approximately 10% of total)

- A person or business that has shown some evidence of generating a positive net cash flow for a minimum of three months (this was later changed to six months as three months trading activity was not considered long enough to make a judgment on the debt capacity of the business).

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<sup>3</sup> Other early microcredit practitioners were Project North East established in 1986, WEETU in Norfolk established in 1999 and Aspire in Belfast and Environment Trust's East End Microcredit Consortium both established in 2000.

Street (UK) estimated this population to be at least 0.5 million to 1 million people. This number was derived from a combination of SBS/DTI data on VAT-registered businesses with less than 5 employees (approx. 2.5 million in 1999) and the market size of commercial consumer lending companies, such as Provident Financial which had about 2 million clients. Street estimated that a significant proportion of people (around a quarter) taking consumer loans use these for income-generating purposes. However, at a certain point (say above a £1,000) these loans are too small and too expensive for business needs.

Many very small businesses find it difficult to get the financing they need from banks. Commercial financial institutions have been through a period of demutualization, mergers and increasing global competition over the last ten years. This has led to a greater focus on profit-making and a shift away from *people-centered* towards more *product-centered* banking. Traditional local banking practices, where lending decisions were made by local branch managers who knew the client personally, have practically disappeared. They have been replaced by new, computerized, automated credit scoring techniques which aim to increase banks' productivity and cost-effectiveness. These methods, while they may have helped increase bank profits, have also increased creditworthiness thresholds such that a diminishing pool of small businesses can get access to bank credit.

Microenterprises, especially those run by low-income people, are seen as a particularly high credit risk. From a banker's perspective, they have limited collateral or personal equity to provide as security and they often operate in small, weak and highly localized markets where business failure rates are seen to be high. Overall, therefore, for commercial banks, the microenterprise lending market is seen as small and risky with little prospect for profit-making. This leaves a market gap which CDFIs, such as Street (UK) aim to fill. Many of the practices that CDFIs have developed are doing what banks used to do – people-centered banking based on understanding clients' willingness and ability to repay a loan.

At the time of Street (UK)'s founding there were many publicly-supported non-bank loan funds and organizations across the UK. The New Economics Foundation estimated that over 200 government supported loan and equity funds were operating in 1999<sup>4</sup>. These funds had certain characteristics:

- The majority focused on supporting pre-start-ups or growing small businesses that could create new jobs. This focus was largely linked to government funding which was targeted towards business support initiatives that either got people out of unemployment or created new jobs. Few recognized the economic and social importance of supporting existing microenterprises, particularly the self-employed. However, the fact is that microenterprises represent nearly 90% of all businesses in the UK, with 68% being businesses with no employees. These businesses contribute nearly 20% of enterprise-

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<sup>4</sup> nef, 2000, The State of Community Development Finance.

generated employment in the UK.<sup>5</sup> Much of this employment is in Britain's most deprived areas, where microbusinesses form the backbone of local economies providing a livelihood for many of Britain's most socially and economically disadvantaged people. In terms of providing loans, existing micro-enterprises also provide a lower risk category of clientele than pre-start-up businesses.

- The majority of funds were very small with low levels of activity. The average number of loans per year was 17. A total of 148 funds surveyed had only 3,000 loans outstanding (excluding Princes Trust with 11,300 loans outstanding).
- Most funds had poor repayment rates and did little to maintain the value of their capital, such that many such funds operated only as short-term schemes, closing down after 1-2 years. There were notable exceptions such as Aston Reinvestment Trust (ART) which was established in the 1980s and had a far greater focus on making sound loans and establishing itself as a long-term viable institution. Because of this, it soon moved into SME rather than micro-lending.
- Aston Reinvestment Trust (ART) and Project NorthEast which were established in the 1980s. These organizations had a far greater focus on making sound loans and establishing themselves as long-term viable institutions.
- The majority of loan funds operated at a local or sub-regional level. An exception was the Princes Trust which provides grants and loans to unemployed 18-30 years old wanting to start their own business. The Princes Trust operates at a national level and supports around 11,000 young people currently. Street recognized Princes Trust as having the closest operating model to their own in terms of operating at national scale.

Two of the factors setting Street (UK) apart was first, their choice of target market and second, the fact that they took a more commercial, market-oriented approach with a greater focus on achieving scale at a nationwide level and sustainability than other organisations operating at the time.

Even today Street (UK) is criticized for their focus on existing grey market micro-businesses. Most policy makers favour supporting start-ups and growing small and medium businesses given the perceived greater economic impacts. The self-employed, particularly those in the grey economy, have not been considered as a business category worthy of public support. Some practitioners also see Street's requirement of at least six months trading history as highly restrictive and a factor which lessens their impact (and market opportunities).

Street's view is that debt is not an appropriate instrument for many business start-ups. Such businesses do not have the cash-flow history to demonstrate that they can afford to borrow and repay a loan. In such a situation a loan is a risky instrument with the

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<sup>5</sup> Source: Small Business Service, data on number of enterprises, employment and turnover in the whole economy by number of employees, UK, start 2002.

business owner potentially ending up worse off if the business doesn't go according to plan and he/she cannot repay the loan. Certainly, experience suggests that grants or informal equity (from friends, family and founders and business angels) are a less risky form of finance for businesses in the seed and start-up stage. Loans are really only appropriate if the business can demonstrate they can afford to borrow and repay the loan.

However, the reality is that a significant number of Street's clients are effectively start-ups. Street takes a very pragmatic approach to their "six months trading history" rule. One client interviewed who had secured Street financing for a car repair workshop had demonstrated his ability to earn money off car repairs through his experience as a teenager doing car repairs for neighbours and friends on the street outside his house. This rule is really away of testing out a potential clients business experience and their capacity to generate income to repay a loan.

## **2.5 Products and Services**

### *2.5.1 Retail Financial Services*

Street UK's primary financial product is a microcredit loan – loans of up to an initial loan size of £10,000 and 12 months to businesses with up to 5 employees. First loans are essentially 'getting to know you loans' during which time Street builds a client relationship and tests out a client's ability and willingness to repay. Repeat loans may be larger and of longer duration. Street requires no physical collateral for their loans, but does require that first time borrowers provide one personal guarantor and two trade references.

Street's interest rate is linked to the loan term and amount borrowed. Their annual percentage rate (APR) ranges from 12.4% for loans above £10,000 and of more than 3 years duration to 26.8% for loans up to £2,000 and 12 months duration.

To many in the UK, including policy makers supporting the development of CDFIs, these seemed high interest rates to be charging to low-income people and early start businesses. Some described Street's rates as "usurious". The approach of schemes in existence at the time was to provide low-cost, below market rates loans, effectively using public money to subsidize interest rates. In some cases, such interest caps were imposed by policy makers. For example, it was EC policy not to allow EC-funded business loan schemes to charge more than 4% over the EU base rate of 6%, leading to a maximum rate of 10%.

Street's interest rate policy is based on three main factors:

- Their policy is to set 'sustainable' interest rates. This means setting rates to cover loan losses and the cost of capital at a minimum (so as to maintain the value of capital funds). Any additional interest income generated is used to cover operating costs. Originally, Street had expected to cover all their operating costs

from interest income over time. However, given levels of demand, this is no longer considered realistic. Street now reckons that they could cover at most one-third of their operating costs from interest earnings; the rest will need to come from trading income from wholesale services and grants or endowments.

- Street (UK) ensures that its rates are affordable to clients. This is done by calculating the cost / benefit of borrowing for the specific purpose for every loan. From a client perspective, Street's rates are considered affordable. Street's rates are well-below the rates of commercial consumer credit companies and moneylenders, the only alternative source of finance for many Street clients. These rates range from 100% to 500% APR for small, short-term loans. When interviewed, Street's clients had no problems with the interest rates and, overall, were very satisfied with their loan terms and conditions (see Section 4.1). This supports evidence from developing countries that people care about access to appropriate financial services, rather than price.
- Street (UK) sets its rate higher than bank SME rates to ensure that it does not serve bankable clients and end up competing with its own funders. Street(UK) believes this is a more effective mechanism than requesting rejection letters from banks (a common CDFI practice).

Today, thanks in no small part to Street (UK)'s influence, there is far greater recognition within the community development finance sector of the importance of setting interest rates in relation to costs so as to contribute to CDFIs financial self-sufficiency.

**Shift from group to individual lending.** During its' initial three years Street has made several modifications to its main loan product. One of the most significant was a decision to shift from group to individual lending only. Street's original proposal was to use a group lending methodology both as a delinquency management strategy and as a means of tackling "social poverty" (which they defined as the lack of availability to an individual of support through social networks, such as friends, family and those one can turn to in times of trouble). Such lending methods have been successfully developed in developing countries.

In the event, it proved difficult for potential borrowers to form groups with a sufficiently diversified risk profile that they could meet Street (UK) credit risk criteria. Street (UK) therefore discontinued group-lending more due to reasons of loan repayment than loan volume. Research by Schreiner (1998, 1999, 2001) highlights some of the problems experienced with peer group lending in the U.S. which are of relevance to the UK:

- Social capital is weak in western countries. People often make their livelihoods from wage jobs or public assistance and are thus not forced to form long-term social and economic relations beyond their family. In the South, people trade and haggle over prices every day of the week. Hence, there are more social linkages within the marketplace.

- The target group of first world microcredit programmes are more diverse, and it becomes difficult to form homogenous groups of like-minded people.
- Even poor people in the first world can get individual loans through credit cards, hence most borrowers would prefer to avoid groups and the high transaction costs of maintaining group relations and coaxing delinquent peers to pay.

That said, some UK microfinance organizations have successfully run different types of peer group lending schemes. All these schemes are with women only. In a recent study of peer group lending<sup>6</sup>, participants in four group lending schemes (WEETU Full Circle, UK, Hordaland Network Credit, Norway, Project Enterprise and Capital Works, Delaware, US) reported that the group lending model was very valuable for their business and personal growth. The process of building social capital was found within all the programmes. Members valued the support and business advice of other members and found it helped build self-esteem and business aptitude. These organizations have also found that the group lending mechanism has kept delinquency levels very low.

Hence, the Street (UK) experience should not lead one to conclude that peer group lending is not feasible to implement in a western context but that it is hard to import trust-based, mutual guarantee system model wholesale. Furthermore, it does suggest that group lending has fairly limited application and seems to work best among women (including ethnic minority women) where the focus is not so much on lending, but as a means of providing mutual support.

## **New Financial Products**

The first new product Street (UK) introduced is a *secured loan for repeat clients* (e.g. taking security over a van if someone borrows for a van purchase). The next products they plan to develop are leasing and insurance products. These products are in the development phase.

*Leasing services* are very valuable to micro and small businesses because they allow companies to use equipment without having to borrow and meet onerous collateral requirements. Although there is a highly developed leasing market in the UK, Street has identified a market gap for people who: (i) have been trading for less than 2 years; (ii) have a poor credit rating; or (iii) wish to lease second-hand goods which are below the re-sale value threshold of mainstream providers. They also know that a portion of their clients would have preferred a lease to a loan. Hence, Street plans to enter this market on a pilot basis.

*Insurance services*, for example insuring tools and equipment or getting public liability insurance, are also important to microentrepreneurs yet often very costly compared to their revenue levels. In developing countries, microinsurance is a growing area of new product development. Among the Street clients interviewed, this was the new product

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<sup>6</sup> Reported on in a forthcoming publication on peer group lending from nef/Prowess written by Unni Beate Sekkesaeter, Bradford School of Management.

most in demand. Four out of the nine clients interviewed when asked the question “what new products and services do you think Street (UK) could offer?” mentioned insurance, with Street playing a brokerage role to help clients get discount prices. Such a product could be of high value to clients but would need to be developed with an insurance company and at a sufficient scale and pricing structure to be viable from both a Street and an insurance company perspective. Street is yet to carry out detailed feasibility work on an insurance product, hence, its development is not yet certain.

### *2.5.2 Business Support*

Integral to Street (UK)’s retail services is a strong focus on providing tailored financial and business advice. This serves two purposes. First, by having an in-depth, practical understanding of the business, Street is able to make better loan decisions and reduce its own credit risk. Second, Street has identified tackling lack of financial literacy and business knowledge and skills as a priority need among their target client group.

Clients’ businesses are far less creditworthy and investment-ready than Street first expected. They estimate that only 30% of business applying to them for a loan are investment ready. This is one contributing factor to the lower than expected loan volumes (see Section 3). It has also meant that Street has placed increasing emphasis and put time into providing financial literacy and business advice. In many instances, Street’s clients have little business or financial information to hand. Hence, Street staff spend several hours talking to clients and gathering information (such as client receipts) to understand their financial situation and build a business analysis and cashflow from scratch.

Currently, Street estimates that 60% of a credit officer’s time is spent on business support compared to 40% on activities directly related to lending. This clearly has major cost implications and suggests that such costs need to be separated out to have a true understanding of the nature and costs of Street’s services and their cost-recovery potential. In order to avoid any conflict of interest between lending and business support, Street(UK) segregates its advice into three categories:

- Information
- Risk identification and mitigation advice
- Business development advice

Its business support for clients is concentrated in the first two categories.

The delivery of Street (UK)’s business advice are embedded in their loan application process. During this process, the Street loan officer takes the client through a systematic analysis of their business. It is worth noting that unlike many business finance and support providers, Street does not expect its clients to have a written business plan which many clients appreciate given the nature of their businesses. Street describes what they do as helping the client to prepare a “business plan without the business plan”.

Street's business assistance includes examination of the following:

- A review of the market position of the business, including a customer and capacity analysis and identification of ways to reduce risk and/or enhance revenue earning opportunities.
- A review of the profitability of the business and the loan amount and purpose requested to ensure that the money is borrowed for the most appropriate (i.e. safest and/or highest income-generating purpose);
- Preparation of cashflow statements, including both business and household income and expenses;
- Signposting with facilitated introductions to:
  - Sources of additional business support
  - Providers of insurance, bookkeeping, legal, premises and other professional services
  - Other clients in a similar business field as themselves, to help develop peer group support.

Once a business has 2-3 employees, Street will provide businesses still operating in the informal economy with a package of support to help them transition to the formal economy. This includes:

- Help with understanding and fulfilling regulatory and licence requirements, public liability and employer's liability insurance, VAT registration, payment of taxes and bookkeeping.
- Help with pricing and a marketing strategy for invoiced (as opposed to cash-based) services.
- Support to build a good enough loan repayment track record that they can graduate with a solid credit history from Street (UK) to a mainstream bank.

Street's business support services are much appreciated by their clients (see Section 4.1). Of particular significance are Street's support services related to the formalisation of informal economy businesses. This is an area which is now getting increasing government attention and potentially represents a niche area for Street to develop its activities further.

### *2.5.3 Wholesale Services to other CDFIs*

The development of wholesale services to other CDFIs has become a key part of Street's business plan since 2002. Street's rationale for developing these services is three-fold:

- First, by supporting the effective operations of other CDFIs, Street will have an indirect impact on expanding retail service provision to clients throughout the UK and fulfilling its national mission;
- Second, they play to Street's strengths and comparative advantages. Compared to many other CDFIs, Street (UK) has strong technical skills and management information systems; and

- Third, such services are expected to provide an additional source of trading income and bolster Street's sustainability.

Street's first wholesale product, launched in July 2003, is StreetServe, a back-office loan administration and management information system, which comes with the opportunity to use Street's ready-made loan documentation.

#### 2.5.4 *Research and Advocacy*

Since founding, Street (UK) has recognized the policy barriers that exist both to encouraging entrepreneurship and self-employment in Britain and to tackling financial exclusion. In 1999, Rosalind Copisarow published a report "The Application of Micro-credit Technology to the UK: Key Commercial and Policy Issues". This set out the case for microcredit and looked at the wider issues faced by clients and microfinance and other community development finance institutions.

Street (UK) has recognized that wider reform of certain areas is necessary to re-shape the institutional, regulatory and policy issues in Britain and to recognise the existence and needs of providing support to the population of people above the upper threshold of charity / welfare and below the lower threshold of mainstream (financial) services. Hence, policy and research work have become an increasingly core part of their operations and one that is seen as vital if Street are to build greater demand for their services.

In November 2002, Street (UK) made their work in this area a more explicit and branded part of their operations, by establishing "StreetLab" as a platform for all Street's policy and advocacy work. StreetLab's main work, to date, has been on the informal economy. Specifically, they have undertaken an action research project, in collaboration with Community Links and the Inland Revenue, to understand the barriers self-employed people face who wish to transition from the informal to the formal sector. The results of this work have led to a series of policy recommendations which are being incorporated into the Social Exclusion Unit's paper on the informal economy and an Inland Revenue paper. Street (UK) and Community Links will also publish their own paper summarizing their findings and recommendations.

One of the most powerful aspects of this research is it is based on people's real-life experience. This work should position Street to play a role in providing *evidence-based* policy recommendations to Government.

## **Business Model**

Street's business strategy was to start their operations with a pilot phase so as to be able to test out their business model. Like other CDFIs, Street (UK)'s initial years of operation have been a time of experimentation and market testing, product development and learning. During this time Street has developed and adapted their business model to reflect the realities of implementation and an increased

understanding of their comparative advantage viz a viz other organizations. Street has taken a systematic approach to testing out different features of their business model, from loan product design to marketing techniques. Appendix 2 provides a summary of the development process, highlighting the different tests done and those which were successful and those which were not.

Based on experience, Street made major downward revisions in their initial lending targets. This led to a certain amount of tension and frustration in their relationship with Esmée Fairbairn. Esmée made its investment on the basis of Street achieving fast growth in lending operations and significant scale and sustainability. Unfortunately, Street, like many other CDFIs, by setting targets raised funder expectations. The lessons learned from this experience are presented in Section 5.

## Key Events in Street (UK)'s History

Street's history can be divided into five main phases. The highlights of these phases are summarized below.

Period	Key Events
Phase I: Market research, fundraising April 1998 – Aug 2000	<ul style="list-style-type: none"> <li>• Trips by practitioners, business people and policy makers to Fundusz Mikro, Poland to advise on applicability to UK</li> <li>• Study tour of US microenterprise lending programmes</li> <li>• Market research</li> <li>• Fundraising</li> <li>• Birmingham head/back office opened – Mar 2000</li> </ul>
Phase II: First pilot and unLTD Sept 2000 – Dec 2001	<ul style="list-style-type: none"> <li>• Official launch of Street (UK)</li> <li>• Sep 00 – Mar 01 – staff hiring, opening of branches in Glasgow and Newcastle, preparation of loan documentation, marketing</li> <li>• First loans made in Mar 2001</li> <li>• Discussions w. unLTD re. Merger</li> <li>• Mar 01 – appointment of Rosalind Copisarow as CEO of unLTD as a merged entity with Street UK</li> <li>• Aug 01 – Bradford office opened</li> <li>• Dec 01 – Rosalind resigns as CEO after lack of clear Millennium Commission support for proposed business model, involving microcredit</li> </ul>
Phase III: Stock-taking post-Street/development of new business plan Jan – Oct 2002	<ul style="list-style-type: none"> <li>• Stocktaking and decision whether to continue</li> <li>• Funding difficulties – EF freezes funding while new business plan developed; Phoenix Fund bid</li> <li>• Closure of Glasgow and Bradford branches/lending slows</li> <li>• Opening of Birmingham and London branches</li> <li>• Recognition of difficulties of UK culture</li> <li>• Development of new business plan w. greater focus on business support services, wholesale services and policy work</li> <li>• 100<sup>th</sup> loan disbursed</li> </ul>
Phase IV: Second pilot phase Nov 2002 – Mar 2004	<ul style="list-style-type: none"> <li>• Relaunch of modified lending and support services, w. new credit assessment and approval process</li> <li>• Improved delinquency management and repayment performance</li> <li>• Nov 02 – Street Lab developed as platform for Street's product development, research and policy work</li> <li>• Jun 03 – Launch of StreetServe – MIS and back-office service</li> </ul>

Phase V: Medium-term development April 2004 onwards	<ul style="list-style-type: none"> <li>• Development of 2004-2007 business plan</li> <li>• Decision for Newcastle to become independent and close-down London</li> <li>• Consolidation of and focus on expanding lending operations in West Midlands combined with development of wholesale services and StreetLab.</li> </ul>
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Phase 1 (April 1998 – Sept 2000) of Street’s history was a period of market research, fundraising, and development work for their launch. Activities during this phase included two study tours to Fundusz Mikro – one by UK community development practitioners, the other by UK policy makers and senior business representatives – to get views as to whether the Polish experience was applicable to the UK; a study tour to the US to see first hand the experience of microcredit practitioners there; analysis of other existing institutions doing business lending in the UK, gaps in supply of services, and potential competition; desk research on potential market size; fundraising for the 2.5 year pilot period.

With hindsight, Street (UK) recognizes that there were certain aspects of the UK that they didn’t gain sufficient understanding of during this research phase, including the need to be embedded and linked with other local partners organisations when developing operations of Street’s type, the need for a Board with more local experience (Street’s Board was dominated by international microfinance experts), the easy credit culture in the UK, and the lack of investment-readiness of many very small businesses. In addition, because both had previously unsustainable organisations, neither had an understanding of the fundraising function in the UK.

Phase II (Sept 2000 – Dec 2001) was Street’s initial pilot phase, during which time they hired staffed, explored locations and opened branches in Glasgow and Bradford, developed their lending policies, procedures and documentation and marketed themselves to potential clients. Street’s first loan was made in March 2001.

However, at the same time as launching their pilot phase, Street was concerned about funding for the post-pilot period, given it had taken two years to raise funds for the pilot. During this time Street (UK) found out about unLTD. This was a new charity formed by seven non-profit organizations each of which support social entrepreneurship. unLTD was selected as a 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 that there might be benefits of merging with unLTD and running the two activities with a single management and single branch structure.

The potential benefits to Street of a merger with unLTD were secure, long-term, mission-related funding on a sufficient scale i.e. financial security; cost savings from joint operations; and positive synergies through the broader range of activities. The potential risks, however, were that Street (UK) would unavoidably go through a period of neglect as senior management focused efforts on getting the merged entity operational, and the risk that the merger wouldn't work out, so leaving Street (UK) back at square one. The Board and funders of Street (UK) reviewed the potential benefits and risks, and ultimately supported Street management in pursuing this venture, provided that Street (UK) activities were not suspended or seriously jeopardized 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.

It is not the purpose of this report to go into the details of this period. However, suffice to say that after nine months it became clear to Street management that there was not a clear and consensus-based agreement among unLTD's Board or the Millennium Commission as to the proposed merged unLTD/Street business model. In the end, with a sense that there was not sufficient support for the merger and that she was potentially jeopardizing both unLTD's bid and Street (UK)'s structure, Rosalind took a decision to resign as CEO of unLTD in December 2001.

Phase III (Jan – Oct 2002) of Street's history was a period of stock-taking post the unLTD experience and development of a new business plan. This was a difficult period. Street had a funding crisis. Esmée Fairbairn suspended their funding wanting to see a new business plan before continuing their support, and Street's application to the Phoenix Fund was turned down. Street also had to let go staff who could only be afforded as part of the unLTD merger. With staff down to a skeleton level, it was difficult to continue to operate and control delinquencies. Given all these difficulties, Street seriously considered whether to continue operations at this stage. Finally, a decision was made to continue but with modifications to Street's lending policies and procedures based on lessons learnt to date (see Appendix 2) as well as a new focus on business support activities, wholesale services and policy work.

Phase IV (Nov 2002 – Mar 2004) saw the restart of Street's operations and essentially a second pilot phase. Several modifications were made to Street's operations including tighter control on lending decisions, better delinquency management systems, and greater support and training for regional managers and staff. Street's performance during this period is analysed in this report.

Phase (V) is Street's future phase. It is expected to be one of consolidation and medium-term development based on Street's 2004-2007 business plan.

### 3. Lending results and financial performance

#### 3.1 Scale of Operations

During the period April 2001 to March 2004, Street (UK) had made a total of 259 loans worth £600,000. The total number of current loans outstanding was 148 with a gross loan portfolio of £304,000 (see Table 1 below). Year-on-year growth in the number of current clients has been almost flat for the last three years. Overall, these results are a fraction of what was originally projected – that is, a total of 3,400 loans disbursed with a total of 1,904 current clients and a loan portfolio of £3.7 million by end 2003.

**Table 1: Street (UK)'s Lending Performance 2001-2004**

	Yr ended 31 March 2002	Yr ended 31 March 2003	Yr ended 31 March 2004
<b>Loans Disbursed</b>			
No. of loans disbursed	70	80	105
Cumulative no. 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
No. 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%
<b>Loan Portfolio/Current Clients</b>			
No. of loans outstanding	59	104	148
No. 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 no. of active loans	-	49%	47%
% growth in net loan portfolio	-	21%	105%

Note: The no. 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.

Despite that fact these results are a disappointment both to Street itself and their funders, Street is performing as well as other CFDIs serving similar markets. Probably the closest peer to Street (UK) as regards client market and lending methodology is Aspire in Northern Ireland. As can be seen from the table below, Street (UK) and Aspire are disbursing a similar number of loans per year. This is also a similar volume

to the Environment Trust's Microcredit Consortium which has disbursed 240 loans in three years to low-income women.

**Table 2: Street (UK)'s and Aspire's Lending Performance 2003 – 2004**

	Yr ended 31 <sup>st</sup> March 2003		Yr ended 31 <sup>st</sup> March 2004	
	Street (UK)	Aspire	Street (UK)	Aspire
Loans Disbursed				
Date of first loan	April 2001	Feb 2000		
No. of loans disbursed	80	90	105	105
Amount disbursed	147,422	280,671	321,668	288,919
No. of first loans	74	50	73	55
Average loan size disbursed (£)	1,843	3,118	3,064	2,752
% growth in loans disbursed	14%	32%	31%	16%
Loan Portfolio/Current Clients				
No. of loans outstanding	104	69	148	114
% growth in no. of clients	76%	17%	42%	65%

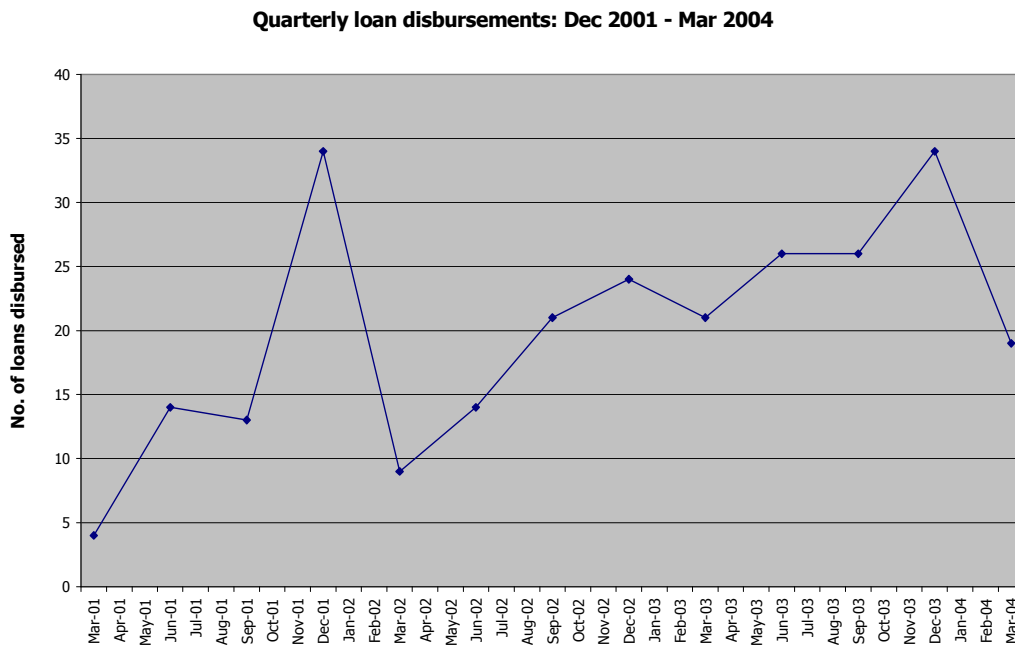
Street's growth, to date, has largely been driven by repeat clients getting larger loans. This is also reflected in Street's increase in average loan size disbursed which has risen from £1,900 in 02/03 to £3,000 in 03/04<sup>7</sup>. Overall, 40% of Street's first-time borrowers take second loans. Of these second-time borrowers, 60% take third loans, and of this pool, 40% go on to take a fourth loan. After their fourth loan, Street expects its clients to have a sufficient credit history to be bankable. Street's high repeat client rates demonstrate client satisfaction and the appropriateness of Street's loan product, as confirmed by client interviews (see Section 4).

However, an ongoing challenge for Street (UK), and other CDFIs, is increasing the rate of growth in new clients. During 2003, the number of new clients per quarter remained constant at 19-20 per quarter. For Street to increase its overall scale of operations this needs to rise. Ways in which Street is hoping to increase their client numbers include developing systematic referrals from banks of rejected loan applications; partnerships with organizations that have a large number of potential clients for Street in their own client base, such as housing associations and citizen advice bureaus; and extending their range of products and services so widening their client base e.g. through financial planning support, insurance and savings products. One promising possibility that has already been acted upon is a partnership with Pertemps Employment Alliance, a subsidiary of a nationwide employment agency, which operates UK and European

<sup>7</sup> It is interesting to note that Aspire have faced an opposite trend seeing a reduction in their average loan size over these two years, both organisations arriving at a similar 2004 result (see table 2).

Government initiatives to help the unemployed find jobs. Street have already had some clients referred through this scheme. They have now located their Birmingham branch office in the Pertemps building which should lead to increase client flows.

Quarterly loan disbursement results have been affected by three factors: duration of the branch’s existence, availability of funding to keep staff employed into the medium term; and seasonality. As regards the latter, for the past three years, the number of loans disbursed has been highest in the fourth quarter and lowest in the first quarter. This is related to the Christmas period, with more businesses borrowing in the September – December period to replenish stock prior to Christmas sales. Street also finds that borrowing tends to be higher in the second quarter of the year. However, as shown in the graph below, two big drops have occurred during periods of branch closures and funding freezes.



So, why have Street’s client levels been so much lower than planned? Several observations can be made:

- This is a new market and not surprisingly market growth and penetration *takes time*. Similar to mainstream businesses, it is likely to take CDFIs 5-10 years to establish themselves with a lot of business development and innovation along the way.
- This is a smaller market than originally envisaged, in terms of loan-ready demand<sup>8</sup>. Street’s high client level projections were too influenced by eastern European and developing country experience where microfinance providers have

<sup>8</sup> Latent demand is still considered to be substantial.

not faced problems of lack of demand and have grown very rapidly. With hindsight, Street (UK) recognizes that the UK and transition/developing economy contexts are very different and there are very different issues which affect market size and demand. This includes:

- A tax and benefits system that provides little incentive for people to graduate off welfare into self-employment because typically benefits terminate long before the business has generated sufficient income to manage without them.
  - The easy availability of credit. People have developed an increased dependency on debt, but often in an uncontrolled way leading to high levels of overindebtedness. This makes Street (UK)'s loan products less attractive given they require a borrower to go through a rigorous creditworthiness assessment process. This rigour can put people off Street's products, even though ultimately they may be 'better for' the client, given Street takes care not to lend people more than they can afford to repay.
  - Lack of financial literacy ie. basic household budgeting skills and basic financial planning.
  - Excessive regulatory and paperwork requirements for microenterprises.
  - Lack of affordable insurance and other risk protection products which may be more appropriate to clients than a loan (or required before they can take out a loan).
  - Lack of investment-readiness.
- This market is hard to reach. The majority of Street's clients are individual self-employed people who have very few links to business support agencies, banks or formal institutions of any kind. This makes it difficult for organizations like Street to find referral organizations which has proved an effective form of marketing for those targeting the unemployed or SMEs. Street has systematically tested different marketing approaches and found the most effective to be newspaper advertisements in local papers – this has yielded half of all its enquiries so far – the largest single source. It has also had some of its borrowers profiled in articles written in local papers. Street(UK) believes that for CDFIs to engage in effective marketing, broader and deeper relationships need to be built with referral organisations, more resources need to be made available for marketing and a marketing strategy needs to incorporate a multi-pronged approach.
  - Street suffered several setbacks during their first three years in operation, including having to deal with the fall-out of unLTD, branch closures and funding difficulties which prevent staff hiring. This is a contributing factor to the flat levels of growth which are now expected to rise, however, even without these setbacks Street would not have met their original targets. They might nevertheless have improved on current CDFI performance.

### 3.3 Cost Effectiveness

One of Esmée Fairbairn's concerns is "was this a good investment?" How cost effective are Street (UK)? To analyse cost effectiveness in a meaningful way one needs to be clear about an organisation's objectives, activities, expected outcomes and impacts. What costs is one measuring against what benefits?

Understanding of expected outcomes and impact can differ among different stakeholders in an organization. This is the case with Street (UK). From Esmée's perspective, the benefit they were seeking from their investment was a large volume of loans to financially excluded microentrepreneurs with resultant impacts on their lives and businesses. As Street has developed they now believe that their benefits are far wider than their lending activities, and include the impact of their wholesale services and policy work. However, we focus our analysis on the cost-effectiveness of Street's lending operations, given this was the main purpose of the grant.

A standard measure of cost effectiveness for microcredit organizations is the operating cost ratio or cost per loan which compares all the administrative and personnel expenses to the average gross loan portfolio outstanding. Simply put, it measures how much money an organization has to spend to lend a pound.

At the start of Street (UK)'s operations, it was costing them £8 to lend £1 taking into account the cost of their entire operations<sup>9</sup>. This is now down to £2.80. Another way of looking at this is the cost per average loan figure. For Street (UK), this cost was £4,380 in March 04.<sup>10</sup>

However, this measure is simplistic. It focuses on lending outcomes only. It fails to take into account the fact that most CDFIs that do enterprise lending, also spend a significant amount of time on business support. This is costly, but as Street (UK) has found, is both a necessary part of making good loans and brings business benefits (see Section 5).

There is now increasing recognition within the CDFI sector of the need to separate out the direct costs of lending from business support services. This is linked to a growing understanding that it is potentially possible to cover the costs of lending from interest revenue provided one can achieve sufficient scale, however business support services are likely to require ongoing subsidy. Some organizations, such as Environment Trust's East London Microcredit Consortium, already separate such costs on a systematic basis. Such cost allocation between lending and business support allows one to do a cost effectiveness analysis on the lending operations only.

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<sup>9</sup> For this calculation we used the "operating expense ratio" which calculated by dividing the total operating expenses by the average gross portfolio.

<sup>10</sup> This is calculated by dividing the total operating expenses by the total number of loans outstanding.

Street reckons that about 60% of their lending staff's time is spent on business support. Using Street's business plan figures for 2004-2007 for their retail lending operations in Birmingham, this works out as a cost of 63 pence per £1 lent on lending activities and 95 pence on business support i.e. a total of £1.58. The implication of this is that Street (UK) would have to charge an interest rate of over 60% to cover their costs of lending from interest revenue alone.

It was difficult to do any comparative analysis in this area due to lack of data. However, based on verbally reported data, it seems that Street (UK) is as cost-effective as other similar CDFIs when one compares their front-office and business support costs. For example, one other CDFI had a cost per loan figure of £2,600 per loan. This is lower than Street (UK)'s figure of £4,300. Differences appear to be due to the fact that this CDFI spends less time on business support and because Street (UK) has significantly higher operating costs (due to having more offices, more activities and higher management salaries). Another CDFI spent an estimated £2,500 per business (around £1 per £1 lent) on business support which is very similar to Street (UK).

### **3.4 Portfolio Quality**

One of Street's objectives was to demonstrate that 'unbankable' micro entrepreneurs were capable of taking and repaying loans. This set them apart from many existing enterprise support programmes around at the time of their start-up, which accepted relatively high levels of default (20-40%) as the price for taking the risk of giving someone an opportunity in business. Street's goal was to achieve at least 95% repayment rates on their loans. This target was based on their Polish and international micro finance experience, where good performing micro finance institutions have consistently been able to achieve high repayment rates of 98-99%, with a portfolio at risk (past 30 days) of less than 5%, as well as that of ICOF who have consistently achieved less than 2% delinquency rates.<sup>11</sup> However, ICOF targets social enterprises which consistently have proven a less risky market than micro and small businesses.

However, from early on in their operations, non-repayment of loans (or delinquency) became an issue for Street (UK). In December 2001, over 50% of clients were delinquent. Although, the majority of the late paying clients did eventually make their payments, delinquency management became a much harder task than Street had expected with staff having to spend time chasing clients, calling on guarantors, representing debit requests and sometimes collecting cash from the client. Due to the seriousness of delinquency rates, Street actually stopped lending for a short time in early 2002.

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<sup>11</sup> The repayment rate measures the amount of on-time repayments compared to the amount due at that time. Portfolio at risk (PAR) measures the total amount outstanding on loans for which there are late payments beyond a specified number of days (e.g. 30 days) compared to the total value of the outstanding portfolio. This is a more forward-looking measure that gives a better indication of what amount of money is at risk of non-repayment and the total amount that might need to be written off in the event of non-collection of the amounts overdue (not just the late payment).

The closure of the Glasgow office (see History of Events in Section 2) had a particularly bad impact on overall delinquency levels. Street did not have the capacity to maintain staff to oversee the repayment of outstanding loans, which meant that many clients didn't bother to repay. Street has learnt from this experience and with the closure of their London office will make sure that there are staff available to maintain client relations and handle loan repayments.

In April 2002, Street (UK) reset their repayment targets recognizing that it was not possible for them to achieve the high, on-time repayment levels they had projected in their original business plan. They also instituted more stream-lined delinquency management procedures, learning in part from Aspire. The new targets were:

- A minimum 30 day collection rate of 75%, with collection rate defined as the total principal and interest amount collected versus the total amount due for the month, within 30 days of the due date.
- A maximum default rate of 15% with 'defaults' defined as any amount greater than 180 days overdue and therefore written off.

During 2003, delinquency levels have improved significantly. The average 30 day collection rate improved from 68% at the beginning of the year to 83% by the end (i.e. above target). Total quarterly write-offs also declined from 30% at the beginning of the year (8% not including Glasgow write-offs) to 4% in the final quarter. Based on current trends, Street (UK) expects a long-term loss rate of less than 10%.

In terms of repayment performance, Street (UK) has experienced similar levels of performance as Aspire (see Table 3). They too suffered a delinquency crisis and had to institute much stricter delinquency management procedures to deal with it. In Aspire's case, the problem mainly derived from delinquency on larger loans taken by repeat customers. This made Aspire become much more cautious about making loans over £10,000 as they felt they did not have the tools and trained staff to deal with them. They have since invested in developing more sophisticated tools for loan analysis and staff training in this area.

**Table 3: Street (UK)'s and Aspire's Repayment Performance 2003 – 2004**

	Street (UK)	Aspire	Street (UK)	Aspire
	Dec 2002		Dec 2003	
Average 30 day collection rate	63%	94%	83%	91%
Portfolio at Risk (past 30 days due)	--	14%	14%	12%

Notes:

Portfolio at Risk is defined as the (outstanding balance on arrears over 30 days + total gross outstanding refinanced (restructured) portfolio)/total outstanding gross portfolio  
It was not possible to compare write-off rates given different measurement methods.

### 3.4 Financial Sustainability

Street's original goal was to earn sufficient income off their lending operations to become a self-sustaining organisation after six years. This was an ambitious goal. It also represented a new way of thinking. Most existing providers of finance at the time operated as public sector organisations, often treating their clients as 'beneficiaries', providing them with subsidized loans and being very lenient on repayment. Street took a more commercial, market-oriented approach. Their aim was and remains to give clients a hand-up rather than a hand-out, expecting them to pay above bank rates for loans and repay on time.

However, what Street has recognized is that given current levels of demand it will be very difficult to achieve the scale necessary for them to become financially self-sufficient. Street's current policy is to set interest rates at a level to cover loan losses and the cost of capital, so as to maintain the value of their capital, with any additional income going into covering operating costs. Currently, Street has an operational self-sufficiency level of 7% (i.e. total income from interest and fees is equivalent to 7% of their total operating expenses). This amount in money terms is sufficient to cover all losses, the cost of capital and a small portion of their operating costs.

It is clear that not all Street's activities can achieve full cost-recovery. The greatest potential for achieving financial self-sustainability is on Street's *retail lending operations* where provided they can achieve sufficient scale Street should be able to achieve a reasonable level of self-sufficiency. However, even this will be a difficult challenge. If one compares Street's interest and fee income to their front office lending costs only, according to Street's latest projections, their lending operations will only be 13% operationally self-sufficient by end 2006/07 increasing to around 30% by 2009.

In the US, where the community development finance sector is over 20 years old, it is notable that no organization has managed to build microenterprise lending operations at a sufficient scale to be financially self-sustainable. Most successful American CDFIs have diversified into other markets to increase their loan fund size and sustainability, including going into small business lending, personal savings and loans, housing construction and renovation loans, loans to non-profits and social enterprises, financial literacy education and business support services. These organisations have gone through a process of change and growth, often starting as micro finance organizations, then widening their range of services, growing and increasing their funds under management over 10 to 20 years.

The development of *wholesale services* is a more recently established area of business for Street. In their latest business plan (2004-2007), Street expects this to become their largest source of trading revenue (covering 13% of their operating costs in 2006/7). This is based on Street having 15 clients within 18 months.

Others within the sector agree that wholesale services to CDFIs will be a growing market and that Street (UK) is well-placed to play a role here. Most consider that the greatest market for StreetServe is start-up CDFIs. For start-up CDFIs, there is real value added in the service which includes operational support handling enquiries, undertaking credit checks, handling loan disbursements, receiving loan repayments, producing client accounts, monitoring arrears, and handling all credit control functions. One potential client said: "We have found the product relevant, user-friendly, practical and very price competitive". Some existing CDFIs, on the other hand, consider StreetServe expensive, have certain issues over its design or believe there are other alternative options available which may be more applicable to them and more cost-effective.

Overall, it is probably too early to judge the level of demand for StreetServe. Street's current projections of having an increasing number of clients over the next year and then seeing this flatten seem realistic in terms of the pattern of growth, given expectations that new CDFIs will not continue to emerge at current rates. However, their target of having 15 clients in 3 years time may be on the high side.

Street's *research and policy advocacy* work under its StreetLab label is an area of activity that needs separate funding or internal subsidy (as is the current case). The approximate cost of StreetLab is £150k per annum. This is a large expense representing 18-20% of Street's total operating budget which puts a considerable strain on the finances of Street as a whole. Currently, Street has no secure income for this area of its activities. Street is aware that it needs to think through carefully how they add value in this area viz a viz other organizations such as the CDFA, think tanks and universities and decide what role they want to play in this area and how it will be financed. Street will consider this over the next few months.

The main question for Street is can they afford to continue this type of work in terms of both time and money. Our evaluation shows that Street is seen to have added some value in the policy area. This is likely to increase with the publication of their joint work with Community Links on the informal economy. However, it is not clear that this value added is sufficient to justify the cost to Street's core budget. Ultimately, it may be best to spin-off this type of activity from Street (UK) or conduct such work on a consulting basis with lower salary and office overheads.

## 4. Social and Economic Impact

This section looks at Street's impact at three levels: the client-level, the CDFI sector level and government policy in relation to self-employment and community development finance

### 4.1 Client-Level Impact

#### 4.1.1 *Are Street (UK) Reaching their Target Market?*

Street (UK) set out to serve the self-employed and owners of businesses with less than 5 employees who were unable to access finance from mainstream banks. These clients were expected to fall into three categories: registered microenterprises, unregistered self-employed businesses and post-start-ups (see Section 2). In addition, Street aimed to serve the most disadvantaged including low-income people and ethnic minority-owned businesses.

Our study found that Street (UK) is reaching their target market – microenterprises which lack access to mainstream financial services. Although no precise data was available on each client category, it appears that the number of registered businesses is higher than originally expected (estimated at around 60% compared to expected 10%). However, although businesses may be registered, Street has found that a lot of these businesses still operate much of their business activity informally e.g. they don't have any formal accounts, they pay their employees on a cash basis and they only pass some of their revenue through their books for tax purposes. Such businesses still need to support to fully integrate into the mainstream.

In terms of client profile, the following observations can be made:

- 30% of Street (UK)'s clients are women (compared to 27% of enquiries that come from women).
- More than half (54%) of Street's clients are from ethnic minority backgrounds, primarily Afro-Caribbean (20%) and Pakistani (16%), followed by black African (5%) and Bangladeshi (3%).
- The majority of Street's clients are in the trade (49%) and services (48%) sectors.

All clients felt that Street (UK) provided them access to finance to meet their business needs that they could not have found elsewhere:

- 7 out of 9 clients had not been willing to approach a bank for a loan expecting that they would be turned away typically because they had a bad credit history (one couple had had their house repossessed for non-repayment of their mortgage; one client had a County Court Judgement for non payment of his student loan; and others had had cheques bounce or run into difficulties paying off loans before).

- Of those 2 clients who had approached a bank for a loan, both had been turned down again both because of poor credit histories and, in one case, because of a lack of business accounts and demonstrated predictable turnover. Even those approaching their own bank had been turned down.
- The majority of clients had never approached more expensive, non-bank lenders for business loans as they do not trust them and find the interest rates too high.
- One client had approached a government enterprise agency for a loan which had eventually been refused. He was very frustrated by this experience as he had spent a lot of time preparing business plans and going to appointments and felt that this had all been a waste of time and effort.

This confirms that there is market gap for financial services for this client group which Street (UK) is meeting effectively. Street has demonstrated that this gap exists, however, there is still uncertainty as to the size of this market gap and hence demand for Street's services.

#### *4.1.2 Are Street (UK) Making a Difference to Client's Lives?*

Street (UK) measures their impact according to client's progression in the following areas:

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

To date, Street's experience has been that for every 10 businesses to which they make loans, 4 businesses (40%) which would likely have been liquidated within the next 12 months have been safeguarded and 4 businesses (40%) have been able to grow and create new jobs. The average number of jobs created by the 4 'growth' businesses is 2.5. Based on this analysis, we estimate that Street (UK) has contributed to the safeguarding of at least 50 businesses and the creation of 130 new jobs over the past three years<sup>12</sup>. This would translate into a cost of about £4,600 per job.

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<sup>12</sup> This is based on the assumption that half of the number of loans disbursed are to repeat clients, giving a total of 130 businesses supported.

One of Street's main offerings for businesses operating informally is a package of support to help them transition from the grey market into the mainstream. No data was available on the number of businesses Street has helped make this transition, however, clearly this is a significant feature of the work that they do from a social and economic perspective.

Although, it was not possible within the scope of this study to carry out a detailed impact assessment, client interviews provide evidence that Street is making a difference both to the businesses they finance and client's lives and well-being. The following quotes provide a sense of the types of impact Street is achieving:

- *"My business wouldn't have started-up without Street (UK)'s support."*
- *"Street's loan helped me establish my own, independent business; before I was simply a partner to a friend who owned the business equipment. They also helped me find an accounting course, which was useful"*
- *Street's loan helped me personally as well. I had recently lost my job and split-up with my wife. This left me depressed. As a result of the loan and my business's success, I gained self-confidence and snapped out of my depression. I'm now back together with my wife."*
- *"Street's loans have enabled us to grow our window cleaning business and buy new rounds".*
- *"Street (UK) helped me understand my cashflow and business turnover which means I now manage my money much better and keep my business accounts separate."*
- *"Street's loan has helped me afford to get married and buy a house because of my increased business and earnings."*
- *"Street (UK) has helped me build up my credit history."*

#### *4.1.3 Are Street's Clients Satisfied with the Quality of their Products and Services?*

Clients are very satisfied with Street's products and services. All clients interviewed were fully satisfied with the terms and conditions of Street UK's loans and the quality of service from Street (UK). In terms of overall levels of satisfaction, on a scale of 1-5, all clients interviewed ranked Street (UK) five or above.

*"We have received two loans from Street (UK) for our window cleaning business and are 100% satisfied with the loan terms and conditions. We can't fault Street one little*

*bit. On a scale of 1-5, they deserve 10!" Doug and Lorraine Scott, Window Cleaners, Tyne and Wear.*

We specifically asked clients whether they thought the interest rate was high, given criticisms of Street for having a very high rate. All clients found the interest rates affordable and had no complaints. Most clients did not see the banks as an alternative so did not compare Street's rate to the banks' business lending rate but rather to moneylenders and commercial credit companies, whose rates they saw as usurious.

However, two caveats must be added. First, we only interviewed "good" clients i.e. those who were repaying on time. It may be that clients who have had problems repaying their loans have a different experience. Secondly, Street's loan products i.e. small, short-term, high interest loans are most suited to services and trade businesses which have a high turnover. They are much less well-suited to manufacturing businesses or those with greater investment and slower return periods. Such businesses would be less favourable towards the terms and conditions of Street's loans. Street (UK) is aware of this and does offer longer-term, investment loans at lower interest rates (12%) for repeat clients.

In the case, where clients had received less than the original amount requested there was no resentment as Street staff helped clients understand their own debt servicing capacity and made sure they did not borrow more than they could afford.

*"The good thing about Street (UK) is that you can't borrow more than you can afford to pay back. My first loan was £1,000. It's less than I thought I needed but a lot when you have nothing. It allowed me to buy essential tools to start my car repair business. When I'd repaid my first loan, I took a second loan for more tools."* Michael Edwards, mechanic, Birmingham.

Several clients said that they planned to go back to Street for repeat loans. For a couple of these businesses, this was the case even if they could build a credit history that would satisfy a bank:

*"Street UK is like a personal friend, whereas with a bank you're just a number. I would like to improve my credit history, but even if I succeed I would always prefer to borrow from Street (UK) than a bank".* Noor Daraz, garage owner, Birmingham

This raises a dilemma for Street (UK) and for other CDFIs with similar client interest in long-term repeat borrowing. On the one hand, from a policy/government funding perspective CDFIs are viewed as a mechanism to help transition people from financial exclusion into accessing mainstream financial services, so creditworthy clients should be referred on to the banks. And Street itself is committed to providing such a bridge to the formal financial sector. On the other hand, for CDFIs such as Street, larger, repeat loans can provide a vital source of income, offering the potential for larger income-margins than first loans which are very labour intensive and costly to make. Hence, it is in the CDFIs' interest to keep repeat clients.

Ultimately, the matter will likely be a question of client choice. Some clients may prefer to stay a CDFI customer, even though interest rates are likely to be higher than bank rates, because of the quality of service. Others will opt to shift to a bank.

As regards business support, the clients interviewed appreciate the advice provided by Street (UK) staff, although some had no need of external advice. Those who found Street's advice useful liked the fact that Street does not take a patronizing attitude and showed a genuine interest in the business and offered practical advice:

*“Street (UK) were very friendly when they approached us and gave us good advice without patronizing us or looking down their noses at us like the banks. Street's staff treated us more like friends than customers”.* Richard Burke, co-owner of a souvenir stall in Newcastle.

*“ The thing I like most about Street (UK) is their interest in my business. They actually care about how my business is doing and are there to offer support and advice, unlike Job Seekers and Pertemps [[check names]] who only cared about getting me off their job seeker list”.* Michael Edwards, mechanic, Birmingham.

Overall, clients think that Street (UK) provides a much better and more client-focused service than banks and government enterprise support agencies. They are regarded as a “flexible and friendly loan company” who cares about their clients and provides appropriate finance and support.

## **4.2 CDFI Sector Impact**

Street (UK) is recognized for having made a positive contribution to the development of the CDFI sector as a whole. This is largely due to the professional experience and dynamism of Rosalind Copisarow and the good reputation of Martin Hockly.

Street is particularly recognized for having a high level of technical expertise in lending and a commitment to performance standards and measurement. Some CDFIs feel that they could learn from Street's lending methodology and overall operations. This bodes well for Street's decision to focus on wholesale services to other CDFIs, although it is too early to judge the level of uptake and impact of these services on the sector as a whole.

There are mixed views as to whether Street has pushed the boundaries on interest rate setting, an area where Street feels they were out there alone trying to get understanding of the need to set sustainable interest rates. Some feel that this is an area where Street has had major influence, in particular by getting recognition that the appropriate comparator interest rate for their clients were moneylenders not banks, hence their loans were comparatively very affordable. Others think that there were earlier advocates in this area, such as those involved with community reinvestment trusts.

Overall, there is a general sense within the sector that there is not enough discussion and agreement on interest rate policy. This is an area worth follow-up where the CDFAs could potentially play a role facilitating open discussion within the sector.

Overall, Street has some work to do to build relationships within the sector. Other CDFAs feel Street's first business plan to establish a national microfinance institution that massively surpassed the scale and performance of existing business finance providers has done some damage to their reputation and credibility and created unrealistic expectations of what was achievable and thereby undermined other organizations. Street is also seen as having been arrogant and not willing to enter into partnership with others. Street is fully aware of this (having encountered considerable hostility on its side) but believes this is based on its own ignorance of the UK practice of partnerships, misunderstandings by others about its activities and intentions and the potential threat to existing funding posed by a new player. Since 2002/3 Street(UK) has been working hard on building its partnerships, with notable successes with Pertemps and Community Links as well as through its CDFAs board role. It has also invested a substantial amount of time sharing its technology, approach and opinions with other practitioners.

### **4.3 Policy Influence**

Since its' founding, Street (UK) have worked to develop a more enabling environment for their clients and for CDFAs. Their lobbying efforts include:

- Contributions to the Charity Commission's category of permitted activities, influencing them to include not only activities that "alleviate" poverty, but also those that "prevent" poverty.
- Strong support for and inputs into the recommendations of the Social Investment Task Force, the establishment of the Phoenix Fund, the Community Investment Tax Relief (CITR) and the new Community Interest Company legal form.
- Awareness raising of the contribution of the self-employed and microenterprises to the economy.
- Research and policy recommendations on the government's stance on and support for the informal economy.

Within the sector, Street (UK) is recognized as being one of several leading CDFAs that has played an important role influencing policy from a practitioner perspective. Rosalind, in particular, is recognized as a highly effective networker and influencer. However, there are mixed views on the impact of Street's influence. Some feel that Street's initial targets raised unrealistic expectations among policy makers and hence their influence has been somewhat of a 'double-edged sword'. Others feel that her

experience, professionalism and passion make her “just the caliber of person the sector needs”.

Street’s policy and research work through StreetLab is still in the early stages of development. The most advanced project is a joint project on the informal economy with Community Links and how government can help people transition from welfare-to-work. Community Links highly values Street (UK)’s contribution in this area, particularly their indepth understanding of the self-employed in the informal economy, their wealth of practical experience and their contribution to developing policy recommendations and lobbying strategies. This informal economy work is very timely and an important area both politically and economically. It is too early to judge its impacts given the work has yet to be published, however, it is expected that this work will lead to change in government policy.

## 5. Lessons Learned and Recommendations

So, what has been learnt from Street (UK)'s experience? This section summarizes lessons learned that seem of relevance to a broader audience, particularly those working with similar clients to Street (UK), CDFIs, grant makers, commercial banks and policy makers. Some of these lessons are directly learnt from Street's specific experience while others represent shared learning by practitioners and other stakeholders in the community development finance sector. Based on these lessons we make a number of recommendations for action to increase the growth and development of very small businesses and the community development finance sector.

### 5.1 Client-level

Street (UK) have reached their target clients and demonstrated that there is the self-employed and microenterprises lack access to finance from gaps. Importantly, they, along with other CDFIs, have demonstrated that access to the types of loans and business advice they provide has a significant impact on the lives of the clients and their businesses – helping secure and increase incomes as well as improve personal well-being. What they have not succeeded in doing is stimulating demand for their services at the scale originally envisaged.

Achieving scale is important, both as a means of achieving financial self-sufficiency and perhaps more importantly as a means to maximize impact on financial exclusion. However, Street (UK) have found that the *loan-ready* market of microenterprises is smaller than they had first envisaged. They do believe, however, that there is a large latent demand. During interviews, we found that this view is supported by other CDFIs targeting the same market.

Street (UK) have learnt that translating this latent demand into loan-ready business propositions requires addressing a number of issues. These include the following:

- Poor basic household budgeting and financial planning skills among the target client group.
- Low-levels of investment-readiness of many very small businesses, which have few basic business planning and financial management tools in place.
- The absence of affordable insurance and other risk protection products that are often a prerequisite to being loan-ready. Research has consistently shown that helping people reduce their risks and income volatility has an even bigger positive impact than increasing their average income.
- A tax and benefits systems which provides disincentives for people who wish to graduate from benefits or cash earnings into formal self-employment.
- Developing a more manageable set of regulatory and paperwork requirements for this micro-business population group e.g. in regard to tax and accounting requirements.

- Encouraging a shift away from a culture which finds debt acceptable, towards the balanced use of savings and debt to finance purchases. Street (UK) had assumed that people would want to move away from inappropriate finance (i.e. very high interest although easily available credit) to more “appropriate finance” of the type Street provides which is tailored to be affordable but requires a more rigorous process of credit assessment. What they have found, however, is that there is a general reluctance (or “stickiness) to making this shift with many people dependent on easy credit.

These findings lead to the following recommendations:

**Recommendation 1 (to CDFI supporters):** Recognize that services to address lack of financial literacy and investment-readiness are integral to stimulating a larger market of loan-ready microbusinesses. This needs to be factored in to the design of business models. It increases the cost of lending but adds value in terms of business impact. The costs of such support should be separated out and funded as part of a CDFI’s activity or delivered by another organisation.

**Recommendation 2 (to CDFIs and business support agencies):** Develop more tailored business aids that enable microentrepreneurs to develop their businesses gradually, with many small but secure steps (e.g. the availability of van rental by the hour, warehouse / storage facilities available in very small units, part time use of equipped business premises, etc.).

**Recommendation 3 (to Government):** Examine policy measures that can build a bridge from welfare-to-work between the social welfare system, the tax and employment system and the financial system.

**Recommendation 4 (to government banks and other financial institutions):** Develop more responsible, people-centered regulatory environment for lending that takes into account particularly low-income people’s capacity to borrow and eliminates the worst of predatory lending practices.

## 5.2 CDFI Level

Among microcredit CDFI practitioners, a key lesson is that there are limits to how much can be learnt from and imported from international microfinance experience. Many in the UK working in the area of microcredit have been inspired by developing country experience. In these countries, there is very high demand for microcredit and it has proved possible to build financially sustainable microfinance institutions, serving very large numbers of clients.

The UK context is very different. Differences include a far more developed financial sector and easier access to consumer credit; a more highly developed and competitive private sector making the chances of survival of a small business lower than in developing country markets; and a highly developed welfare system that includes disincentives for people to graduate off welfare into full-time self-employment. These factors reduce the market size and scale of demand for microcredit and, hence, make it difficult to translate business models from abroad.

In the UK, the CDFI sector is still at a very early stage of development and no proven business models that can achieve scale and sustainability have yet emerged. One lesson from Street's experience is that it appears unrealistic to expect to build a financially self-sufficient CDFI specializing in microlending alone – Street's original business model. Increasingly it appears that diversification of products and services in response to demand is key if one is aiming for scale and increasing levels of self-sufficiency. Many CDFIs have now recognized this but are developing different business strategies in this regard. These strategies include:

- Developing a greater range of products and services targeted at microenterprises as well as a niche as a wholesale provider of services to CDFIs and other enterprise-related organizations – the Street (UK) approach
- Diversifying into new markets e.g. SME lending or social economy lending – a development path taken by many US CDFIs and currently being considered by Aspire.
- Providing both personal loans (where demand is greater) as well as microenterprise loans – several community reinvestment trusts, such as East Lancs Moneyline (elm) and Portsmouth Area Reinvestment Trust (PART) had developed lending operations focused on personal loans, with a small volume of microenterprises loans.
- Developing lending activities as a separate activity of an already viable and sustainable organization – as has been done by some enterprise and housing agencies.
- Developing a new community banking partnership model which combines the strengths of credit unions, CDFIs and potentially other financial and support providers, such as banks and money advice agencies, to provide an integrated range of financial services and money advice, including savings, loans, debt advice and bill payment services.

In general, we expect that the next few years will be a period of ongoing experimentation and change for many CDFIs. We also expect that given funding difficulties and efforts to increase viability there will be an increasing number of mergers and partnerships among CDFIs i.e. a greater consolidation of the sector over time.

If funders are to understand a CDFI's business model and the costs involved, CDFIs need to become much more transparent. Already there is growing agreement that the costs of lending need to be separated out from the costs of outreach and business support. Ideally, one would be able to cover the costs of lending from interest and fee income over time, whereas business support is likely to always need public subsidy.

**Recommendation 5 (to CDFIs):** CDFIs specializing in microcredit should take care when importing foreign microfinance models, ensuring they are adapted to the cultural and economic context of the UK, and starting small-scale, to minimize the investment / cost during the piloting / adaptation phase.

**Recommendation 6 (to CDFIs and the CDFA):** Greater sharing and peer learning should be encouraged among CDFIs to explore and learn from successes and failures in developing viable business models. The CDFA is already playing an important role in this regard through events, such as the annual CDFA conference.

**Recommendation 7 (to CDFIs):** Consider ways of increasing market research and evidence of demand before introducing new products.

### 5.3 Grant makers/philanthropic funders

Street (UK)'s, like other CDFIs', initial years of operation have essentially been a time of market testing, product development and learning. Unfortunately, Street (UK) did not couch their proposal to Esmée Fairbairn explicitly in these terms. Rather expectations were raised about the prospects of achieving fast growth in lending operations and significant scale and sustainability. This has led to a certain amount of tension and frustration in the grantor-grantee relationship over the last three years during the process of reevaluating targets and business strategy when risks and impact (return) have often seemed hard to judge.

So, what can Esmée Fairbairn and other grant makers learn from this experience? Some lessons can be learnt from the private sector. Businesses entering new markets typically find it very difficult to secure financing from mainstream banks precisely because the risks and returns are unknown. Such businesses have to turn to venture capitalists for start-up financing. These funders provide the business with capital (equity) for a long-term period, typically 5 to 7 years. Particularly when investing in small or start-up business, they become part owners of the business and typically have

a position on the Board and a close relationship with the management team, offering advice and helping to raise additional finance.

Henry Drucker, widely recognized as one of the founding fathers of modern fund-raising in Britain, has looked at how the approach of venture capitalists might be applied to foundation grant-making (see table below). One key difference he highlights between venture capitalism and foundation grant-making are the terms of engagement. He notes that the terms of engagement for venture philanthropists are based on a very close relationship with the business (they are “joined at the hip”), small portfolios and partnership, whereas foundation terms of engagement with fundee organisations tend to be based on an arm’s length relationship, large portfolios and oversight. World in Need is one UK foundation already taking a venture philanthropy approach.

Another key difference is in the attitude towards failure. A venture capital fund will typically invest in say 15-30 businesses, expecting 20% to be very successful, 20% to fail and 60% to struggle or have fairly mediocre performance. Foundations typically don’t start off funding an initiative expecting that it might fail. That said, clearly many projects and organisations do fail or perform less well than expected. Being open to and accepting of risk is vital if foundations are to take a more venture philanthropic approach which can lead to greater rewards and increased learning. Recently many UK foundations have begun to reexamine their grant-making approach, including recognizing the need to be more open about and learn from failure. However, greater clarity is needed by foundations on their grant-making approach. Currently, there seems to be a certain degree of uncertainty among foundations as to their willingness to take and share in risks.

Grant funders such as Esmée Fairbairn, can play a vital role in building new institutions by taking a longer-term, venture philanthropy approach. Such funding is vital for institution-building and fills the gap between targeted, project-type grants and loan financing.

In making decisions, it is advisable for grant funders to recognize that social entrepreneurs, like all entrepreneurs, tend to be optimistic by nature. Often social entrepreneurs are entering uncharted territory where there is little market knowledge or experience to learn from. They have a vision of what’s possible and it is this vision that provides their motivation and drive. Such was the case with Street (UK). If social change is to happen such social entrepreneurs need to be backed. However, funders also need to be assured that such entrepreneurs have a good business idea and the capacity to build an organization. This may not always be their strength, so ensuring other good managers are in place is vital. And it may be that there comes a time when the visionary social entrepreneur needs to move on once the organization has established itself and needs a different style of leadership.

One lesson from Street’s experience is that it may be advisable for grant funders to think about special parameters and rules when funding complete start-ups versus existing organizations. The following principles could be applied:

- Assume that the first few years are going to be a time of action research and pilot testing, so have a flexible frame of mind as regards outcomes.
- If a funder is providing more than 50% of organisation's revenue, recognize that any delays or stoppage of funding will have a major impact on that organisation's operations. In this situation, funders become more of a partner sharing in risks and rewards). Grantees also need to recognize that it may not be advisable to rely on a single majority funder.
- Use appropriate performance targets for a start-up. In the early years of an organization's operations, it will be difficult to put quantifiable targets on outputs, such as number of loans. We would suggest that funders consider including linking their funding to more organizational development measures as well as delivery targets. After 2-3 years operations, it will become possible to set quantifiable targets based on historical performance. In the case of Street (UK), there was an early focus on lending targets. This was partly led by Street (UK) itself setting ambitious targets and Esmée's buy-in. These targets were changed early on, however, because of high initial expectations a sense of underperformance persisted which does not reflect the fact that Street's performance is as good as, if not better than, other similar CDFIs in the sector.

Grant makers also need to consider how to better leverage their money. In a sector such as community development finance, there are financial risks to investors seeking a financial return. Grantmakers can help underwrite these risks. Co-investing in CDFIs directly or in wholesale intermediaries which on-lend to CDFIs are ways in which foundations and commercial funders can achieve better leverage.

Capturing and sharing learning is an important function of grant making given the role grant makers play in social change. For the Street (UK) investment, despite its' size, there were clear reporting requirements but no structured, learning process built in as part of the grant. When making future grants of this nature, consideration could be given to building in an evaluation and feedback process from which both parties learn and share experience and decision-making during the period of the grant.

**Recommendation 8 (to grant makers):** Consider taking a venture philanthropy approach when investing in start-up and early stage organizations with a sense of shared risk and long-term engagement.

**Recommendation 9 (to grant makers):** Consider co-investing in CDFIs with commercial funders as a way of leveraging grant funds and using their knowledge of good lending practices.

**Recommendation 10 (to grant makers):** Build in an evaluation and learning process during the grant period, particularly for large grants.

## 5.3 Commercial banks

Ultimately, the vision of community development finance is to create a mainstream financial system that works for all. This means recognizing that a range of institutional models are needed to deliver financial services to all, particularly those on low-incomes. It also means taking down barriers that separate the efforts of CDFIs from those of the formal financial sector and domestic capital markets.

Partnership between commercial banks and CDFIs that builds on their relative strengths is vital to achieving this vision. Commercial banks can play several partnership roles including:

- Wholesale funding for CDFIs
- Establishing client referral systems as part of local bank business policy
- Sharing infrastructure and systems
- Providing training, technical expertise and staff to CDFIs
- Partnering on new product development e.g. incentivized savings schemes.
- Developing commercial banks products that are appropriate for the financially excluded.

To date, many banks have seen supporting CDFIs as part of their corporate social responsibility or community involvement agenda. Most bank funding for the sector has come from CSR or community budgets. Barclays Bank provides funding to Street (UK) and has developed a model to attract in financing from their commercial operations to the sector. Barclays use their charitable funds to underwrite the risk, so providing an internal subsidy such that the commercial arm lends to CDFIs at 1% over base. There are limits to this model, particularly the amount the central community budget can afford to underwrite commercial lending. However, this structure has provided an incentive for getting commercial finance into the sector. Over time, it is hoped that CDFIs will build their own creditworthiness and be able to borrow commercially on a direct basis, with the Community Investment Tax Relief providing sufficient incentive to do so.

### **Recommendation 11 (to commercial banks and other financial institutions):**

Recognize that the role of the financial sector is to provide financial services to all. Mainstream partnership with CDFIs as part of bank operations at all levels through the types of activities described above.

## 5.4 Government policy makers

The UK government has been one of the most pioneering governments in Europe when it comes to recognizing and taking action to tackle financial exclusion. They have supported the creation of a number of measures, including funding, to support CDFIs. However, CDFI development is a long-term process requiring 5-10 years for organizations to establish themselves. There are fears that central government may discontinue funding of CDFIs via the Phoenix Fund and expect RDAs and local government to address funding needs. This could endanger the sector by placing

CDFIs in an even more precarious funding situation than they are already subject to the vagaries of regional and local government where there are widely differing levels of local knowledge and commitment to the CDFI sector. Such a move could be catastrophic given the early stage and fragile nature of the sector.

To date, government policy and action has focused on increasing access to finance for *businesses*. However, it is widely known that there is financial exclusion in the area of personal finance e.g. the lack of affordable, consumer credit for low-income households. Furthermore, many CDFIs are increasingly finding that most viable institutional models are those that provide a diverse range of financial services including both personal and business finance. There is need for more joined-up government policy and an opening-up of funding to tackle financial exclusion on a broad basis not just for enterprise.

**Recommendation 12 (to government):** Continue investment in a dedicated CDFI fund for at least 5 more years, while encouraging regional and local government to support CDFIs.

**Recommendation 13 (to government):** Broaden the remit of the Phoenix Fund to provide financing to tackling financial exclusion generally, not just enterprise finance.

**Recommendation 14 (to government):** Making mainstream business support more relevant for microentrepreneurs.

**LIST OF INTERVIEWS**

**Street (UK) Staff and Board**

Rosalind Copisarow, Director  
Martin Hockly, Director  
John Hall, Regional Manager, Newcastle  
John Kilcoyne, Regional Manager, Birmingham  
Kate McKee, Board member  
John Tackaberry, Board member

**CDFI Practitioners**

Sharon Fereday, Sandwell Advice and Moneyline  
Niamh Goggin, Aspire, Belfast  
Faisal Rahman, Environment Trust/East London Microcredit Consortium (Reinvestment Trust)  
Steve Walker, Aston Reinvestment Trust

**CDFI Supporters**

Sarah McGeehan, Community Development Finance Association  
Peter Kelly, Barclays Bank  
David Irwin, ex-Head of Small Business Service

VARIABLES TESTED	SUCCESSFUL TESTS	REJECTED TESTS	COMMENTS
<b>LOAN TERMS</b>			
Maximum 1 <sup>st</sup> loan size	£10,000	£3,000	People tend to wish to borrow 3 times as much as their cashflow permits. 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 1 <sup>st</sup> loan term	12 months		A short 1 <sup>st</sup> 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.
<b>MARKETING</b>			
Marketing methods	Formal referrals from community / public sector organisations, banks and bookkeepers; Informal referrals; Newspaper advertising.	Leaflets; Cold calling, Radio advertising; TV documentary; Billboards; Commission agreements with trade wholesalers and finance	Referrals work best because people are pre-disposed to / informed about / more suitable for Street(UK) service.

		brokers..	
Marketing brochure(s)			
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.	
Enquiries 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.
<b>LOAN ASSESSMENT PROCESS</b>			
Credit policy issues			
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 proximity 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.	50% maximum debt service ratio on investment loans; 65% maximum debt service ratio on working capital loans.	Borrowers need a much bigger cashflow cushion than we anticipated, to cover high volatility, partly caused by poor financial management.

<p>Legal / regulatory compliance</p>	<p>Minimum attitude towards graduating into a formal business; No minimum compliance level.</p>	<p>No minimum attitude towards graduating into a formal business.</p>	<p>Minimum attitude constitutes a) borrower's personal aspirations to formalise; and b) willingness to listen to/accept Street(UK) advice / support.</p>
<p>Reference-taking</p>	<p>2 trade references (1 client + 1 supplier) + credit reference with Experian agency (+ reduction in no. of guarantors required).</p>	<p>No references taken but 3 guarantors required instead.</p>	<p>We conduct 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) county court judgements (CCJs); and e) related CCJs, eg for family or household member.</p>

## Appendix 3

VARIABLES TESTED	SUCCESSFUL TESTS	REJECTED TESTS	COMMENTS
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 $\leq$ £3,500 loan amounts.	Minimum credit experience needed by at least one 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. We will next develop a shorter form for smaller loans.
<b>DELINQUENCY MANAGEMENT</b>			
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 best because it avoids cash and paperwork. (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 enforcement 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 reschedule.	
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	We have concluded that the court process works in maybe 3/10 cases, usually where borrowers do not already have CCJs. We have therefore discontinued to use it for all other cases. The current use of debt collection agencies instead is a recent development. Still too early to

## Appendix 3

		Street(UK) staff).	tell how effective it is.
<b>BRANCH LOCATION</b>			
Population size	200,000+ pop. city (Newcastle, Birmingham).	50,000 – 100,000 pop. town (Bradford).	Smaller towns can be served with one part-time staff but in general, a pop. size of 50,000 is needed for a 2-3 person branch.
Ethnic / socio-economic composition	Minimum no. of existing micro-enterprises; Ethnic minorities in general; Women in general.	Extremely deprived areas with few micro-enterprises (Leaside area, London); Bangladeshi women; Indian pops.	Street(UK) clients include at least a proportion of female and ethnic minority people in the pop. as a whole. Exceptions: Bangladeshi women possibly need softer terms and more support; Indian people prefer to use own savings; 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 manager. This is not possible with current infrastructure unless the distances are small. Difficult to get ongoing RDA funding for local branches of a co. with HQ outside the RDA region.
No. Branches Per Region	As many as possible, subject to pop. size / demand.	One (Newcastle, Birmingham, London).	
<b>STAFF RECRUITMENT</b>			
Main pre-requisites for region manager	Management / corporate background; Sales experience; Networking skills with referral orgs / funders; [MBA, own business experience helpful but 2 <sup>nd</sup> 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	Own business experience with emphasis on street skills.	

## Appendix 3

	years) and a balanced mix of 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.	No bonus system.	Bonus criteria mainly tied to loan volume and repayment targets, but also recognise contribution with lending process and teamwork / co-operation.

### Comparison of Venture Capital vs. Foundation Approaches

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

Source: **WANTED: UK VENTURE PHILANTHROPISTS** by H. M. DRUCKER  
Oxford Philanthropic