

Community finance for London

Scaling up the credit union and social finance sector

Executive Summary

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Executive summary

The research study was designed to provide a platform for the development of affordable credit solutions and community finance for London. The study was developed as a collaborative and participative inquiry involving the leading credit union and social finance providers in the capital, and their key partners in central and local government and the social housing sector.

It explores how the credit union and social finance sector might scale up so as to meet the ever-present need for access to affordable credit and financial services that are suited to the needs of those on low and modest incomes. London encapsulates many of the challenges faced by the wider credit union and social finance sector in ensuring community finance contributes significantly to the fight against poverty and worklessness and to the building of strong, inclusive and economically vibrant communities.

The report focuses particularly, but not solely, on credit unions. Apart from one social firm, credit unions are the only community finance organisations engaged in the provision of affordable credit in London. The thinking and solutions proposed in this report are intended therefore as a contribution to the wider policy debate on how most effectively to modernise and scale up credit unions in London and on a national scale.

There is a pressing need for affordable credit in London and for flexible financial services that meet the needs of those on low incomes

London faces a pressing need for affordable credit and financial services. London includes some of the most deprived communities in the UK. Much of inner London is in the top decile of the Index of Multiple Deprivation. Almost a quarter of the housing stock in the capital is social housing, rising to half in some boroughs in East London.

Low-income¹ Londoners differ in profile from those on low incomes in the national population. They are more likely to be in work and less likely to be benefit dependent but nonetheless average household income for Londoners on low incomes, at £11,240 p.a. lags the national average for low income households of £12,175. This is despite being more likely to face higher housing and other costs. Some 27% live in private rented accommodation compared to 17% nationally with low-income Londoners less than half as likely to be home owners as low-income households nationally.

A major feature of the low-income population in London is its ethnic diversity. Some 49% of low-income Londoners describe themselves as white, compared to 86% nationally. Almost a quarter of low-income Londoners describe themselves as black while 16% describe themselves as Asian. Overall ethnic minorities, including white central Europeans, represent 57% of the low-income population in London.

Borrowing is entrenched in the harsh reality of life on a low income and, for many is the only way of managing cash flow and funding major purchases. Some 57% of low-income Londoners are credit users. Credit use is driven by a lack of savings safety nets and competing pressure on budgets that are too tight to manage peaks of expenditure, unanticipated events and high ticket essentials. Some 61% of Londoners have no savings. Three quarters (74%) of Londoners would find it difficult or impossible to raise £200 – £300 in an emergency without borrowing while 83% could find it difficult or impossible to save £500 towards a special purchase.

Credit is less available to low-income Londoners than elsewhere

Patterns of mainstream credit use among the low-income population are similar in London to those elsewhere, albeit that the incidence of mainstream credit use is lower than it is nationally for all mainstream product categories. Where London does appear to differ significantly from the wider low-income population is in patterns of sub-prime credit use, most notably in use of home credit, the leading sub-prime source of cash credit for low-income households nationally.

¹ Defined for the purposes of this study as falling into the lowest 50% of household incomes.

Use of home credit at 3% of the low-income London population, or 115,000 individuals is a little over a fifth of the level that pertains for low-income households nationally. While home credit use broadly follows the distribution of disadvantage it spans a wider spread of communities than the most deprived and is concentrated primarily in low rise estates and outlying suburbs with relatively little penetration in the inner city and in minority ethnic communities. Use of pawn and Cash Converters is similar to national levels but penetration of newer sub-prime credit models such as rent to own and payday lags the national incidence among low-income households. Use of social lending is also much lower than it is nationally. Half as many low-income Londoners borrow from the Social Fund (7%) as is the case nationally (14%) while use of credit unions, at 1% of low-income Londoners, is half that for low-income households nationally. As a consequence low-income Londoners are more reliant on informal borrowing (at 19%) which is almost as important as overdraft finance (22%) and credit cards (21%).

However many low-income Londoners are not able to access credit, with 39% having used no credit in the last five years, rising to 45% of BME households. This compares to the national average of 27%. Eight in ten low-income Londoners believe that they would find it difficult or impossible to borrow £200 – £500 from a mainstream financial institution. More than a quarter of non credit users claim to have had a credit application refused, with half of these being in the last twelve months. This implies that there are 250,000 low-income Londoners with a need to borrow who are unable to do so. Unmet need for credit is reflected in illegal money lending. Some 12% of low-income Londoners are aware of illegal money lending in their own community, rising to 18% in poor white communities. The experience of the London illegal money lending team suggests that illegal lending is also a feature of ethnic minority communities where exclusion is greatest.

There are 0.75m low-income Londoners with a need for affordable credit

Taking together all users of high cost credit and those with a need for credit and not able to borrow we estimate the potential total need for affordable credit to be 0.75m individuals, representing some 30% of low-income Londoners and 42% of social tenants in the capital.

Credit unions are growing rapidly in Greater London but membership remains modest compared with other large conurbations

There are 35 credit unions operating within Greater London; and anyone who lives or works in 27 of London's 33 boroughs can now join a credit union. There are plans to expand credit unions into two further boroughs. Some Londoners can also join a credit union through their employer, local church or association. Throughout London, credit unions are working in partnership with statutory, voluntary and community organisations, with the main partners in London being local authorities and social landlords. This assists in community outreach and enables them to reach particular target groups; and often strengthens credit union capacity to deliver appropriate and affordable financial services.

Credit unions are growing in London faster than they are in Britain generally. In the period 2005 to 2009, credit union assets have grown by 92% (national increase, 44%), loans by 70% (national increase, 36%), savings by 79% (national increase 39%) and membership is up over 90% (national increase, 39%). In 2009, there were around 60,000 members in London credit unions, and, since 2005, membership has been growing at about 18% per annum.

However, to date, even with this growth, credit union membership in London remains modest compared with other large conurbations. It represents about 1% of the total Greater London population; compared with 3% on Merseyside and 5% plus in Glasgow. In areas served by credit unions, membership is strongest in Southwark, Tower Hamlets, Newham, Greenwich and Lewisham.

The DWP Growth Fund has acted as a catalyst for growth and change but highlights also the capacity gaps in credit union coverage in some parts of London

Overall, but with some exceptions, the credit unions that have grown most significantly in London are those that have delivered the Government's Financial Inclusion Growth Fund. Five Growth Fund credit unions more than doubled their membership in the period 2005 – 2009.

Since the start of the DWP Growth Fund in September 2006 and up to March 2011, credit union contractors in London granted over 44,000 loans to people on low incomes and opened over 25,000 current or savings accounts for Growth Fund borrowers. From 2005 – 2009, savings were up 81% in Growth Fund credit unions, compared with 47% in non-Growth Fund live or work credit unions.

There is significant variation in the extent to which different credit unions are equipped to grow

The ability of credit unions to expand the provision of affordable financial services depends ultimately on their economic strength, organisational capacity and operational efficiency. Credit unions range from professionally-managed financial institutions, visible in the marketplace with the capacity to offer a range of financial services, to traditional, community organisations often serving a smaller membership base. Membership in individual credit unions in London ranges from just 30 to over 12,000 members.

The major financial challenges facing credit unions lie with achieving cost efficiencies, maximising savings and ensuring effective on-lending

A significant number of credit unions are not yet generating sufficient income to fully sustain and capitalise the business

Expense-to-asset ratios can often be high, and credit unions recognise the need to maximise income and to reduce costs through driving efficiencies in systems and procedures. This can be a major challenge as many credit unions do not yet have the skills, experience or resources to make rapid progress in re-engineering the business. They require high-level technical systems analysis and assistance to drive cost efficiencies.

Most London credit unions still depend to some extent on external financial or in-kind support to meet expenses and to develop the business

With support, credit unions have been able to hire staff, to develop new products and services, to improve IT and to operate out of high-street premises. Overall there is a reducing dependency on external financial support, but some London credit unions are still highly dependent on Government, local government or others to sustain operations and service delivery.

Most London credit unions have controlled bad debt fairly satisfactorily. 87% of Growth Fund credit unions, for example, had less than 10% delinquency on loans, which is regarded as reasonable given the target market. However, controlling bad debt has been highly problematic for some individual credit unions.

Maximising savings will be critical to success and requires a widening of the savings base

Credit unions generate funds for on-lending primarily through attracting the savings of their members. Growth and financial sustainability will require a widening of the savings base. This will involve widening and diversifying the membership profile.

The new credit union legislative reform², expected in 2011, will also offer credit unions a range of new opportunities to maximise savings: these include the introduction of corporate deposits and deferred shares and the ability to pay interest on savings deposits. The importance of the urgent implementation of this new legislation was stressed by all credit union participants.

Nonetheless raising additional funds for on-lending will also need to rest on subordinated loan arrangements and investment by partners and third parties, such as housing associations, local authorities, charitable trusts, and potentially, even, the Big Society Bank. This may be assisted by the possibility of corporate deposits, permissible through the new legislative reform.

² Legislative Reform (Industrial and Provident Societies and Credit Unions 2010).

Effective lending and realistic pricing will be essential to optimise financial stability and ensure that serving high maintenance borrowers can be sustained

For some credit unions, the lending business is not performing at a rate or a size to achieve optimum financial stability. Even with capital funds to on-lend, a credit union requires a sufficiently robust, well-performing business lending model to turn those funds into income. The average loan-to-asset ratio among live-or-work credit unions was around 56%. The World Council of Credit Union recommends that 70% – 80% of assets need to be out on loan in order to achieve financial stability.

High operating expense costs are endemic to serving high-maintenance borrowers with small value loans. This led to a call by credit union managers for greater flexibility on pricing and for raising the interest-rate cap on lending.

Operational and management challenges rest on common vision and focus, partnership and effective use of information technology to support growth

A step change in leadership, governance and management will be needed to drive the movement forward

The expansion of credit union financial services throughout London will entail higher level skills and competencies in strategic planning, organisational management and systems, financial and asset management, credit administration and debt recovery, and human resources. A step-change in the strategic thinking of boards and in the overall competence of management will be needed if credit unions as a whole are to develop as co-operative financial institutions with the capacity to serve large numbers of low and moderate income Londoners.

There is currently significant diversity in product and service offerings and it will be important to develop a common offer while remaining rooted in local communities

Variations in approach and capacity have resulted in credit unions offering products and services that are often dissimilar from one another. This diversity has led to inconsistencies in quality of product and service delivery. As a result partner organisations can feel that there is no single clear message that can be communicated about the benefits of joining and using a credit union.

Refocusing the credit union business to serve a wider target market will be critical to the ability to serve those traditionally excluded

Too narrow a focus on those on very low incomes is not sustainable within a growth strategy. All credit union managers interviewed were keen to refocus the business to serve a wider segment of the low and moderate income market. Credit unions now rather aimed to be inclusive financial providers, with those historically excluded from the financial services sector served alongside a wider range of members.

Developing information technology will be key to effective financial management and growth

Credit unions need to invest in information technology to ensure the effective credit assessment of loan applications, the control of bad debt and the management of loan portfolios, as well as the computerisation of administrative information systems. They also need to introduce online access and card services which are now standard throughout the financial services sector. Many individual credit unions, however, have limited resources to make significant advances in upgrading information technology.

Effective partnerships with a range of partner organisations will be key to scale and engagement with communities and local economies

Credit unions, together with other social lenders, have the potential to collaborate with local authorities, social landlords and others in building prosperous, vibrant and cohesive communities. In turn, local authorities and social landlords have an important supportive role in enabling their development. Local authorities and social landlords increasingly expect credit unions to be organisations with which they can do business, and require consistency in product quality and service delivery as a pre-condition of partnering with credit unions to widen access to affordable financial services.

The future is collaborative: the challenge of radical change

This study strongly argues that there is a compelling case for a move away from an atomistic business model to one based on collaboration and shared services. It is collaboration that offers a real opportunity to build scale and efficiency in the sector whilst maintaining the community finance ethos and vision that defines and differentiates it from the mainstream.

The way forward in expanding access to credit union financial services lies in greater credit union collaboration and in the development of a cohesive and comprehensive system of shared services.

Collaboration enables credit unions to gain economies of scale, to improve the efficiency and effectiveness of operations and service delivery, to enhance brand recognition and strategic marketing and, importantly, to enable smaller credit unions to offer the same level of service as larger institutions. It presents a radically new approach to the business and calls for a cultural shift in the way boards and managers think about operations. The focus is on commonality rather than uniqueness; and on operational excellence in credit union service delivery.

Recommendations

The report contains a comprehensive list of recommendations for the credit union sector, Government and partner organisations. The following are key headline recommendations:

Credit unions in London should:

- Recognise, in common with many credit union movements world-wide, that long-term success in expanding credit union financial services depends on the development of a collaborative credit union system and that without collaboration, there will be no real future for the movement in London as a meaningful provider of affordable financial services on any scale.
- Seek to widen their target market and prioritise the development of a wider range of financial products and services which meet the needs of low and moderate income working people, and which attract a broader range of people to join credit unions.
- Introduce modern electronic delivery channels for financial services in London. These would include internet and telephone access, SMS and mobile phone technology, and card services with ATM access and debit card facilities.
- Focus on the development of enhanced financial management skills and the highest governance standards. Weak and vulnerable credit unions should be encouraged to transfer engagements into stronger credit unions to benefit from collaboration and protect the integrity of the movement in London.
- Transform operation efficiency through taking a lead in ABCUL's new back office project and their initiatives on collaborative credit assessment and debt recovery as the means to achieve both short term wins and long term collaboration.
- Pioneer the link with the Post Office, which has the potential to open up access to credit union products and services to a wider population in London.
- Work with Central and Local Government, social landlords and other agencies to build an increasingly modernised and professional credit union movement in London and to revitalise and strengthen local communities.

The full report can be downloaded from:

www.ljmu.ac.uk/HEA/financialinclusion/index.htm

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