Building a local financial eco-system for a post Covid-19 recovery

Tony Greenham & Frances Northrop, 6 October 2020

We propose two simple and powerful forms of regional financial institution which would drive more widespread prosperity while improving the social and environmental performance of local enterprise.

1 Context

Business regeneration

Many SMEs will not survive the economic disruption of Covid-19, particularly in hard hit sectors such as hospitality, food, independent retail, cultural and entertainment sectors.

However, the demand for such services has been only temporarily suppressed (this is the theory behind the V-shaped, or 'bounce back' economic recovery). Additionally geographical areas that traditionally host and/or lend themselves to small businesses are proving more resilient and there is an opportunity for area-based regeneration around growing and greening the local economy to take advantage of this unexpected shift.

Therefore, there is an opportunity for new business start-ups as well as a need to transform existing business models to meet the ongoing challenges of covid-19 and a just transition.

There is evidence that small owner-managed businesses have a high social value through a higher employment relative to sales[1], building and maintaining social capital[2] and retaining a greater proportion of business profits within communities. In addition to the 15% of SMEs that are defined as social and charitable enterprises[3], a further 16% define themselves as socially-orientated because they place social goals as equal to or more important than profits.[4]

Can we build back better by improving the social and environmental quality of business and supporting more small businesses, social enterprises and community business[5] as a core aspect of rebuilding the economy?

Spreading ownership and wealth

Land/property owners may also not survive the crisis or may need to sell some assets to realise cash in the short-term. This will be compounded by public authorities following the by now well-trodden path of the sale of capital assets, formerly to meet their statutory duties in the face of austerity cuts and now additionally to meet the costs incurred during the Covid-19 crisis.

However many landlords will be hoping to hold onto their properties by keeping them empty so that they don't lose their book value - but there remains a long-term sustainable use for their assets which will require good local intelligence and relationships to enable negotiation to open them up to occupation/sale. The ability for public commons partnerships between local councils and civil society

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[1] Reference – can we justify this assertion?
[2] https://ilsr.org/walmart-destroys-social-capital-study-finds/
[3] By for example having an asset lock or a defined social mission
[4] BEIS (2018) LONGITUDINAL SMALL BUSINESS SURVEY 2017: SME EMPLOYERS
[5] with legal forms such Community Investment Companies, Community Benefit Society; Co-operative Societies and Companies Limited by Guarantee

organisations to form special purpose vehicles and for funds to be made available through pooling resources is critical to ensuring the generative uses of these buildings and land.

Changing patterns such as home-working and more localised consumption is forcing a rethink of existing land and buildings, for example disappearing footfall from out of town retail centres and office commuting centres.

The short-term loss of rents, and severely impaired local government finances, may drive fire-sales or both private and public land and property and fuel the concentration of ownership and wealth in the hands of private developers who do not have a long-term presence or commitment to the communities affected by their actions. Something which will be exacerbated by the new planning reform proposals.

Can we build back better by spreading ownership, wealth and economic participation in land and buildings, especially those of high community value and those that are essential to a vibrant local economy?

2 Analysis

What is required?

1. Business advice and support, particularly for smaller businesses, new entrants and mission-led businesses. Also for those who might be anticipating retirement with no-one to pass the business on to which could then become an employee ownership situation. Recommendations on business advice is outside the scope of this briefing[6]
2. Sustained demand for the products and services that local businesses are able to provide. Our working assumption for this briefing is that at least for a significant proportion of people, the experience of Covid-19 has sparked greater appreciation, and demand, for local services.
3. Appropriate finance for small businesses, start-ups, non-standard corporate forms such as cooperative societies and community interest companies and finance for transformation towards more social and environmentally beneficial business models (see below).
4. Access and control of land and buildings, and/or landlords with community benefit goals, that enable businesses to invest on the basis of secure tenure, to configure buildings to fit their business needs, and to benefit from the broader economic value their businesses generate which is expressed in rising land values (see below).

Appropriate business finance

Larger SMEs with established track records and collateral against which loans can be secured have had good access to bank finance over the past few years from an expanding range of lenders.

In contrast, bank debt is not generally suitable for start-ups[7] and businesses seeking significant changes in their business model, and therefore without an established track record, or those unable to offer security have more difficulty accessing appropriate and affordable finance.

[6] But see forthcoming NEF report - advice is most successful when relational
[7] Start-up Loans from the British Business Bank aim to address this gap

Furthermore, mission-led businesses have ownership and governance structures that are generally unfamiliar to banks which acts as barrier to finance.

The shift to digital banking and the consequent retreat of banks from communities through the loss of relationship managers and branches has eroded their capacity to lend to small businesses where local and context knowledge is required for sound lending decisions.

Finally, there is a need for the full range of finance from grants and risk-sharing finance (equity) as well as debt. The British Business Bank operates three regional venture funds (Northern Powerhouse, Midlands Engine and Cornwall), but have many eligibility rules attached and are also more focused on existing trading businesses with high growth potential. There is also a myriad of grant schemes and highly targeted social impact loans but many businesses with high social value will fall between the cracks.

Access to and control of land and buildings

Currently there is little in the way of regulatory and/or legal frameworks to enable greater local/community control/purchase of land and buildings beyond Compulsory Purchase legislation. However, the work of the Scottish Land Commission on a Scottish Land Fund and Compulsory Sales Orders and examples from the US, including Community Land Trusts (which are already taking hold here) and Community Land Banks (still in their early stages) are inspiring action here.

There is a growing coalescence around the need for an English Land Commission, with research currently being undertaken by NEF into establishing this body to explore the potential for a practical infrastructure to bring land and buildings into public or commons ownership.

3 Proposal – towards a local finance eco-system

We suggest there are three categories of institutions required to work in close partnership and a local /regional spatial scale to take full advantage of the opportunity to build back better with vibrant enterprises with high social value. Only the first category is currently in existence.

Community finance institutions

Some parts of the country may already have an active and successful enterprise lending CDFI, but many places don't, and even where a successful CDFI exists they can have conditions placed on use of funds which will prevent them addressing many of the needs identified above.

RECOMMENDATION: Much work has already been conducted in this space, for example by Big Society Capital, and we support these existing initiatives to strengthen the CDFI sector.

Community venture funds

An innovative, more flexible enterprise and asset development fund that raise finance and deploy it in a range of ways including:

- ‘first-loss’ funding for funding high risk and/or new ventures that can blend funds from various places – eg Shared Prosperity Fund, one off programmes like Stronger Towns, City Deals, Future High Streets etc, alongside philanthropic monies and investment from the National Lottery, Trusts and Foundations.
- issuing community shares and bonds to local people that are backed by existing investments in land, buildings and established businesses or can be shielded by a ‘first-loss’ tranche.
- additional bank loan finance to leverage impact.

The fund should have greater leeway over defining social value and impact than afforded by existing funding siloes that impose tightly defined criteria. High quality governance and accountability structures, with local intelligence and relationships as well as appropriate conduct regulation, would be essential to ensure funding is mission aligned. The appropriate scale would be at city/borough level, with populations of approximately 100,000 to 1 million, with mechanisms to allow for devolving funds down to neighbourhood level.

This is consistent with the proposal of the Community Wealth Fund Alliance for a new Community Wealth Fund to invest in ‘left-behind’ neighbourhoods. However, it is distinct and complementary in seeking to stimulate enterprise and in being relevant ultimately to all places, not just the most economically marginalised.

RECOMMENDATION: Pilot a community venture fund in at least three places, preferably spanning a rural area, key/core city and secondary urban settlement and hinterland (eg larger market/coastal town). Scoping study to identify and consult key stakeholders already providing one of more of the elements of the proposed fund.

Community bank

To recirculate local deposits to reinvest in the local economy, supporting the long-term banking needs of these businesses including deposits, current accounts as well as bank credit. This model already exists in the form of the proposed regional mutual banks (see South West Mutual and Avon Mutual for examples).

RECOMMENDATION: Create a capitalisation fund for regional mutual banks from dormant assets or other appropriate sources which can match fund regional private, social and public investment.