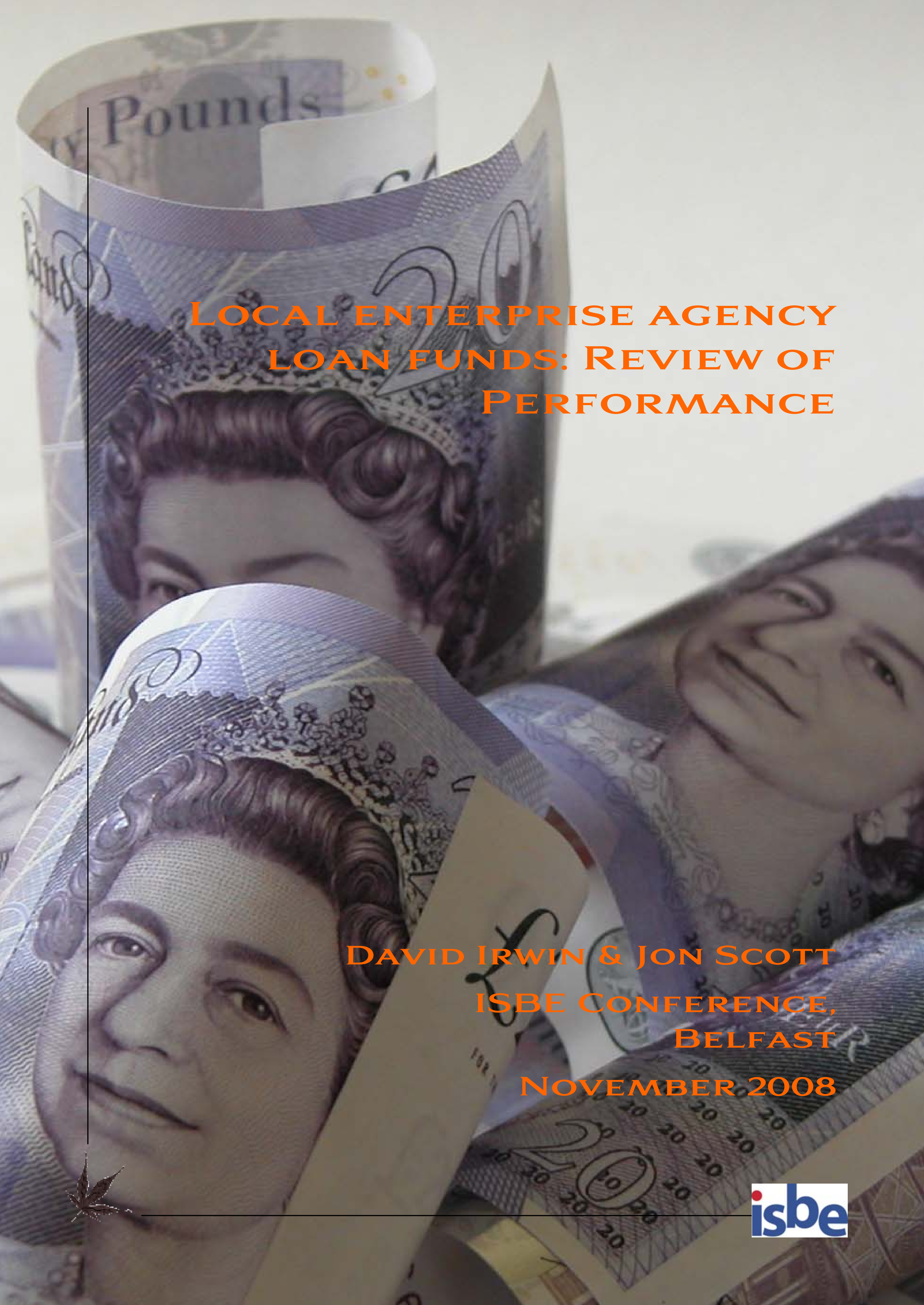

Local enterprise agency loan funds: Review of Performance

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Local enterprise agency loan funds

Review of performance

Abstract

Objectives: This paper, drawing upon annual surveys of local enterprise agency (LEA) loan funds in the UK, aims to consider whether these loan funds are addressing the apparent finance gap experienced by small firms.

Prior work: Although there has been significant research into Business Links, it mainly focuses upon advice and support rather than access to finance (see, for example, Oztel and Martin, 1998; Bennett and Robson, 1999a, b; 2000; 2003; 2004; Bennett et al, 2000a, b; Bryson et al, 1997; Hutchinson et al, 1996; Mole, 2002; Mole et al, 2008; Robson and Bennett, 2000). Conversely, there is relatively little specific literature on enterprise agencies and none on LEA loan funds, although the wider microfinance and community development finance literature provides insight.

Approach: All of the enterprise agencies offering loan finance were contacted and asked to complete a short Excel based template providing data for their loan fund performance during the previous year and for their performance from inception till the end of that year.

Results: Micro-finance is important though with the number of new starts growing rapidly, the micro-loan funds growing slowly, and the growing ease of accessing funds from commercial sources, they appear to be increasingly less important. Enterprise agency loan funds have a high conversion rate, presumably because many of those referred have come from LEA advisers and so the propositions unlikely to be supported have already been weeded out. The level of demand and high conversion rates also suggest that knowledge of the existence of these loans is still low. How demand will change in the current economic climate is unclear. The support from enterprise agencies is genuinely additional in that clients would not otherwise be able to raise the finance that they need. Enterprise agency loan funds are becoming more efficient but are still not, and are unlikely to become, wholly sustainable.

Implications: Almost certainly, more effort needs to be made to promote the availability of micro-finance. It is likely that the real need for a prospective entrepreneur is effective advice and support which will assist in unlocking the necessary financial support so the most effective micro-finance institutions, measured by survival and growth of clients, are likely to be those that can provide effective advice and support alongside their loans.

Value: This paper contributes to understanding how and whether LEA loan funds make a difference. Although the Community Development Finance Association produces data, it does not focus solely on LEA loan funds. Practitioners are looking for evidence that funds do make a difference because that will help them when they come to raising money – and benchmarks hopefully will drive funds to improve their performance.

Keywords: Small firms, finance, loan funds, enterprise agencies, performance, micro-finance

1. Introduction and context

This paper, drawing upon surveys of local enterprise agency (LEA) loan funds in the UK in each of the last three years (Irwin, 2006, 2007, 2008), aims to consider whether these loan funds are addressing the apparent small firm finance gap by analysing their performance. The rationale for this paper is that there is little understanding of the difference that they make in enabling prospective entrepreneurs actually to start in business, though practitioners will argue their importance as part of a package of support. Although there are a wide number of performance evaluation measures used for developing country Microfinance Institutions (MFIs), there has historically been a lack of such evaluation in the UK. Collin et al (2001) highlighted a lack of performance measures for community development finance institutions (CDFIs) in the UK, though this has now to some extent been addressed by the Community Development Finance Association (CDFA), launched in 2002, through its annual reports entitled Inside Out. These, however, cover more than just local enterprise agencies (and so include consumer lending as well as business lending) and exclude any fund that is not a member.

The primary aim of UK government enterprise policy is to stimulate the start up of new firms (Storey, 1994; Green et al, 2008). Providing start-up finance for small and medium-sized enterprises (SMEs) is one way of achieving this aim (Wren and Storey, 2002; Tucker and Lean, 2003). In 2007, 425,300 firms started up but, on a cautionary note, 492,600 ceased (Barclays, 2008). A new enterprise strategy (HM Treasury and BERR, 2008) has been introduced which supersedes the previous action plan for small businesses (SBS, 2004). Bennett (2008) provides a fairly positive assessment of Government business support, but queries its value for money and suggests that lower spending could form the basis for a 'tax cut'. Richard (2008: 5) goes further suggesting that, given the significant administrative cost of business support, RDAs and Business Links could be abolished and replaced by 'a single, web-based Business Information Service'. Notwithstanding doubts about whether government involvement in credit markets is effective (Craig et al, 2007), it appears that there may be significant problems in UK public sector SME support in disadvantaged areas and amongst under-represented social groups (Fielden et al, 2006; Rouse and Jayawarna, 2006).

Mole et al (2008: 317-318) identified 'five distinct phases' of UK policy to support small firms: first, the Enterprise Allowance Scheme in the mid-1980s; second, the Enterprise Initiative in the 1980s (though it should be noted that EAS and EI were aimed at quite different target audiences); third, 'decentralised' support through Business Link sub-contracting to enterprise agencies and other organisations; and, finally, in the last decade, two further phases of restructuring and rationalising Business Links, including giving Regional Development Agencies (RDA) control of Business Link in their region. Such support is predicated upon Government or public sector intervention to correct market failure (Atherton et al, 2002; Mole and Bramley, 2006). Throughout the past 20 years, with considerable support from the private sector and often from local authorities, the role of enterprise agencies has been primarily to provide support and advice to people who wish to start and grow a business.

As an extension to their role of providing business support, many local enterprise agencies established their own loan funds. The first loan funds appeared in the mid-1980s, largely in response to the difficulty faced by many of their clients in raising finance from commercial sources. A number of agencies were able to raise funds from a variety of private and public

sources; Shell helped with funds for six agencies and the creation of the Shell Enterprise Loan Funds which helped to raise the profile of enterprise agency loan funds. The Youth Enterprise Scheme, with finance from 3is, and the Prince's Youth Business Trust specifically focused on supporting young people to start in business. More recently, PRIME has been aiming to assist older people with start up finance.

These funds were designed to assist clients who have an apparently viable business proposition but, for whatever reason, are unable to borrow from commercial sources the money that they need. These were intended to be 'funds of last resort', though they were often willing to make the first offer to maximise leverage from commercial sources. Enterprise agency funds were boosted in 1998 following the Government's Policy Action Team's (PAT 14) articulation of the difficulty faced by some businesses in accessing bank finance. They believed that many were potentially viable enterprises, but their age, experience, track record or business structure made them unattractive to the banks. The Social Investment Task Force's report in 2000 confirmed these conclusions and highlighted the value of developing enterprise within disadvantaged communities and the government provided additional funding, through the DTI's Phoenix Fund, to support community development finance institutions (CDFI). It also created community investment tax relief (CITR) to provide a tax incentive to investors (whether through equity or debt) in CDFIs.

Whilst there has been significant research into Business Links, it mainly focuses upon advice and support rather than loans (see, for example, Oztel and Martin,1998; Bennett and Robson, 1999a, b; 2000; 2003; 2004; Bennett et al, 2000a, b; Bryson et al, 1997; Hutchinson et al, 1996; Mole, 2002; Mole et al, 2008; Robson and Bennett, 2000). There is relatively little literature (except for Bennett, 1995; Bristow and Munday, 1997; Gibson and Sloan, 1991; and Kirk-Smith and Gault, 1995) on enterprise agencies and none on LEA loan funds, although the wider microfinance and community development finance literature provides insight (see, for example, Collin et al, 2001; Mullineux and Mayo, 2001; Derban et al, 2005; Forster et al, 2006; Satta, 2006; MIX, 2006; McGeehan and Goggin, 2008; Providential Financial plc, 2008).

Some 41 LEAs were listed in the National Federation for Enterprise Agencies (NFEA) directory in 2005 as having their own loan funds though the number has now dropped to 29. Many more assist clients to access loan funds managed by others as well as assisting clients to access commercial sources of money. Whilst not all would claim that they are solely offering micro-loans, many of them primarily or exclusively focus on that part of the market. Furthermore, they are all lending specifically to people wanting to start or grow a business, mostly for-profit but increasingly also social. Micro-loans are usually defined as loans of less than £15,000. Many micro-finance institutions (MFIs) are part of a business support organisation or else, like the Prince's Trust, have established a network of mentors to provide business advice alongside the finance.

The remainder of this paper is structured as follows. Section 2 explores the existing literature in relation to the well-established area of small firm finance, but widens this somewhat with a consideration of market failure in such finance and the need for LEA loan funds. Section 3 outlines the methodology by which this research was conducted and Section 4 comprises the results of the study and a discussion of their implications. Finally, Section 5 provides some conclusions from the study.

2. Small firm finance, market failure and loan funds

2.1 What we know about SME finance

Previous studies have established that loans from banks are the predominant source of UK firm finance (Cosh and Hughes, 2003; Fraser, 2005; British Bankers Association, 2006), that financing constraints can lead to business failure and yet many entrepreneurs do not wish to use long-term debt finance (Kotey, 1999). It is generally assumed that business owners adopt a 'pecking order' of financing preferences where they use personal finance and funding from family and friends, then banks, before approaching equity sources (Howorth, 2001).[1] Most businesses, however, are forced into this by lenders – who expect to see commitment from the entrepreneur expressed through investment of their own money first, which is known as 'signalling'. Indeed, this was another reason behind the creation of many enterprise agency funds. They were working with people with interesting business ideas and no, or very little, resources of their own, and a small loan from a fund was often viewed by the banks as a substitute for personal equity. Figure 1 shows estimates of amounts outstanding to small businesses at the end of 2007 (apart from Asset Based Finance Association figures which are for 2006) from a number of sources.

Figure 1: Sources of finance for SMEs

Sources: CDFA (2008), Inside Out; British Bankers Association (2007); Finance & Leasing Association (2007); British Venture Capital Association (2007 Q3); Asset Based Finance Association (2006)

Cressy and Toivanen (2001) found that

> 'better borrowers get larger loans and lower interest rates; collateral provision and loan size reduce the interest rate paid.'

Banks approach the lending process in a risk-averse way (understandably, as they have an obligation to protect savers' deposits), and thus turn down propositions perceived to be 'riskier'. Market failures in finance provision, or a 'finance gap', may not exist for many SMEs but start-ups may experience finance constraints (SBS, 2004), perhaps because of the lack of a track record or, more likely, a lack of collateral, although their proposition may otherwise appear viable.

It is this lack of sufficient collateral that is the motivation behind government backed loan guarantee schemes. The objective of such schemes is to provide a guarantee to commercial lending institutions when the only objection to providing a loan is a lack of collateral.

[1] However, the pecking order theory was originally based on large-scale American corporate ventures and it has been argued that it simply does not apply to small-scale start-ups (Atherton, 2006).

In previous research, we found personal savings to be the biggest source of finance for most new businesses (Irwin and Scott, 2006b), while young entrepreneurs mainly used family and friends finance followed by micro finance (Irwin and Scott, 2006a).

2.2 Business Links

As discussed in the introduction, small firm support policy has been conceived in 'five distinct phases' (Mole et al, 2008) with a specific focus upon advice and other non-lending support. The majority of the analysis of Government-backed business support has concentrated upon Business Links which, although acknowledging the role of sub-contracted support and brokerage, critiques and evaluates the effectiveness of the central 'hub' organisation. In effect, Business Link can be conceptualised as a 'virtual organisation' incorporating the sub-contracted services delivered by enterprise agencies and other providers. However, in referring or signposting business owners or potential entrepreneurs to other organisations, the 'torch' is then passed to them. Given the large amount of effort spent on researching business advice (and other forms of 'non-financial support' – Mole and Bramley, 2006), on the one hand, and debt and equity finance from commercial sources, on the other, our focus is necessarily very narrow – on loan funds provided by LEAs.

Good advice and support should make individuals more investment ready and steer them towards developing a viable proposition. A study of business advice and mentoring for start up in Scotland identified a number of impacts of business support, for example in making clients more focused on objectives; to have a greater use of business planning; to focus on profitability as opposed to sales turnover/cash; and being 'able to learn to manage their businesses and to cope with change' (Deakins et al, 2000: 165). It is clear that business planning (Mason and Stark, 2004; Richbell et al, 2006) and the production of a formal business plan or strategy can improve investment readiness. However, it has been observed that the question of whether business plans are appropriate at all, or used by successful entrepreneurs, is rarely addressed in academic research (Bygrave, 2007).

2.3 Enterprise Agencies

Although we provided an overview of Enterprise Agencies in the introduction to this paper, there is a small amount of literature focusing upon these organisations (e.g. Bennett, 1995; Bristow and Munday, 1997; Gibson and Sloan, 1991; and Kirk-Smith and Gault, 1995), as well as the general business support they can provide (Boocock et al, 1994).

One of the earliest studies of Enterprise Agencies was Moss (1988), who assessed both what new ventures were seeking and what Enterprise Agencies sought to deliver. The shift in emphasis of Enterprise Agencies towards promoting self-employment for the unemployed, and outsourcing to public-funded Training and Enterprise Councils (TECs) and Local Enterprise Companies (LECs) has been highlighted (Bennett, 1995).

Most papers provide little, if any, insight into Local Enterprise Agency loan funds, although their more general consideration of LEA business advice is helpful. Bristow and Munday (1997: 719) observed that: 'much of the performance data still relates to enterprise agency estimates of clients assisted, jobs created, courses run, grants assessed and investment levered in.'

There is some evidence that public sector loans to new ventures can lead to job creation (Almus, 2004). Although Almus' research is from Germany, it is nonetheless helpful in supporting the argument that Enterprise Agency loans

are effective in terms of their outcomes or outputs for assisted firms. A Barclays Bank (2001) tracking study, undertaken in partnership with the enterprise agencies, found that clients supported by an agency – generally, not just loan fund assisted – were more likely to survive (especially when experiencing 'financial distress'), and most significantly had, '[f]aster and more sustained growth amongst surviving firms; and [s]igns of better overall financial management and measured risk taking'. Taken together, these studies provide clear support for the role of Enterprise Agencies in improving the prospects of assisted firms.[2]

There were few published performance measures in the UK, according to Collin et al (2001). Derban et al (2005) examined loan repayment performance in UK CDFIs and both borrower and institutional characteristics influence this performance, while Glennon and Nigro (2005) explored the issue of borrowers defaulting on loans. Other measures of performance in loan funds have been examined, for example, by Riding et al (2006) and by Cowling and Mitchell (2001). Satta (2006), Microfinance Information Exchange (MIX) (2006) and McGeeehan and Goggin (2008) highlight the state of the art in CDFI and microfinance performance evaluation.

2.4 Objectives of research

There are mixed views about whether enterprise agencies and other business support organisations make a difference and almost no views about whether micro-lending provides any additionality or whether the people who are helped would have done it anyway. For the individuals supported, however, there is no doubt that most of them would say that they could not have started without the guidance, encouragement and support that they received from their adviser. That leaves the question of whether a loan fund is a necessary part of the 'tool-box' or whether entrepreneurs could, in reality, raise all their required funding from commercial sources.

Based on practical experience and our previous research, our hypotheses are

(a) enterprise agency loans support entrepreneurs and prospective entrepreneurs who would otherwise have been unable to raise the finance that they require (that is, there is a high level of additionality);

(b) loan funds support clients in such a way that they can progress to utilising commercial sources, effectively releasing modest resources to support more clients;

(c) enterprise agency loan funds are unlikely ever to be wholly sustainable but, if they deliver a high level of additionality, deserve to be supported.

3. Research methodology

CDFA undertakes a survey each year of their members, but CDFIs are not lending exclusively to businesses and, in any event, not every enterprise agency loan fund is a member of CDFA. The objective of this research, therefore, was to build a picture of enterprise agency lending. Those agencies who participate each year are subsequently sent benchmarking data showing how they perform against the rest of the survey participants.

All of the enterprise agencies offering loan finance were contacted just after Easter each year and asked to complete a short Excel based template to provide data for their loan fund performance during the previous year and for

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[2] Other studies on business support include, for TECs and LECs, Chaston (1992), Vickerstaff and Parker (1995).

their performance from inception till the end of that year. The template was designed so that for regular participants, there was only a need to provide the previous year's data, and the cumulative data updated itself. There is a list of data gathered in appendix 1.

In 2006, there were 16 responses from 40 funds (41%); in 2007, there were 13 responses from 37 (35%); and in 2008, there were 11 responses from 29 (38%), reflecting the diminishing number of enterprise agencies and of funds. Indeed, since launching this survey, Great Western Enterprise and Entrust have both wound up loan funds, though Entrust has recently launched a new one; TEDCo has transferred its fund to a LEGI project; South East Northumberland Enterprise Trust has closed, and transferred its loan portfolio to Project North East. Three of the enterprise agencies in south east England, one with a fund, have just merged. However, we have been successful in having a core of regular contributors to the research.

In 2008, a number of respondents qualified their returns.

Bolton Business Venture, for example, noted that, since the demise of Phoenix Community Finance Initiative, they have reviewed and tightened their lending criteria, resulting in them making fewer loans. They also note that their more risky loans, under Phoenix criteria, resulted in a higher number over 90 days overdue and loans written off. However, they are also seeing an increase in the number of loans repaid in full.

Project North East reported that in 2007 they experienced a significant reduction in applications, which they ascribed to the impact of the merging the local Business Links and the loss of local advisers, rather than to a general cooling down of the small business start up market.

The North East Business & Innovation Centre (NEBIC) explained that its loan fund had originally been set up to run for three years as a Business Link product with public funds from One North East. This meant that it would cease on 31 March 2007, though they anticipated that it might continue lending until the funds dried up. However, this date coincided with the formation of Business Link North East, who decided a loan fund was not a product they required. NEBIC is, therefore, now collecting outstanding monies over the lifetime of the loans and returning to One North East. To add to the confusion, One North East sees the need for more SME funds and has contracted with Entrust and others to start new loan fund.

The results from the funds are merged into a single spreadsheet and ratios are calculated. The figures are analysed to give medians, inter-quartile ranges and, where appropriate, weighted means. See Appendix 2 for a note on definitions. Detailed results for a number of the performance figures are provided in appendix 4.

4. Results and Discussion

4.1 Lending

In 2007, respondents received 520 loan applications (down from 613 in 2006 and 805 in 2005) and provided 323 loans (down from 488 in 2006) totalling £3.8m (down from £4.6m in 2006), suggesting that it is not only PNE that has seen a dramatic fall in the number of applicants. However, looking at the total number of applications is not particularly insightful when the sample population changes, albeit not by much, each year. It is perhaps more interesting to note that the median number of loans dropped by 25 per cent in 2006, but was back up in 2007 to more or less the same level that it had seen in 2005.

The conversion rate of applications to loans, at two thirds, is high, though it has slipped a little in 2007, perhaps reflecting the support that the agencies are able to give to clients before they apply for their loans.

The smallest loan of any fund is just £500. The largest is £150,000, though this is unusual. The median smallest loan is £500 (down from £1,000, perhaps reflecting higher demand for smaller loans); the median largest loan is £20,000. The weighted mean loan size in 2007 was £10,580 (though the median was lower at £7,860, suggesting that larger funds do bigger loans) down from £10,250 in 2006. This is comparable to CDFA figures for all micro-lenders. According to CDFA, the average loan to a micro-enterprise in 2007 was £8,520 and to a small business was £28,000.

Leverage is a measure of the effect funds have in encouraging others to lend alongside them. In 2005, the best fund achieved leverage of 4.4: in other words, for every pound they lent, a further £4.40 was lent alongside from other sources, so they perform a service that is far more important simply than their own lending. A high level of leverage might imply that (some) borrowers were nearly bankable. The experience of the LEAs is that non-commercial finance, allied with advice and support, can make a significant difference to the whether the banks will lend. Funding from MFIs is seen by the banks as quasi-equity, so potentially turns non-bankable propositions into bankable propositions. The challenge for the LEAs is to lend the minimum amount required to bring a bank on board. In 2007, total lending of £3.8m leveraged a further £2.9m from commercial sources. However, not every agency records leverage. If one looks at the figures for the agencies that do record leverage, the median was 1.7 with an inter-quartile range of 0.5-1.8. If the clients were going to the banks themselves, generally the banks would expect a gearing of no worse than one, so they are being more generous to LEA clients. This is almost certainly for three reasons – the screening by the LEA and desire to preserve their reputation resulting in referring lower risk proposition, the expectation of continuing support from the agency once the client has started up, and the micro-loan. Leverage of 1.7 confirms that the agencies are being successful in introducing clients to commercial sources, but is still fairly low suggesting that the clients would not otherwise have been supported. This does not provide conclusive evidence to support the first two hypotheses but does suggest that both are likely to be true.

It is regrettable that fewer funds record the level of leverage that they are achieving, given that one objective of micro-finance should be to lever in additional funds.

4.2 Quality of portfolio

Portfolio yield is an indication of how much a fund 'earns' from the monies out on loan. For a fund that is largely or wholly capitalised through grant aid, this may only be of academic interest. However, for funds that borrow their money, it is an important figure since fund managers can compare their yield with the cost of borrowing the money. At 5.5 per cent (and a mean of 6 per cent), only one fund (achieving 11 per cent) would have made a margin – and this doesn't allow spare capacity for replenishing the written off capital. According to CDFA, the portfolio yield for CDFIs averaged 7.2 per cent, though the range varied from one per cent to 16 per cent, so LEAs are only marginally worse.

In 2007, for the first time, we asked about the number of loans more than 90 days overdue, which some observers regard as a better indication of performance than write offs (mainly because funds can choose when to write

off a defaulting loan). Some 156 loans (up from 143) loans worth £1.5m (up from £1m) are more than 90 days overdue. Whilst this may seem high, it has barely changed, suggesting that it is at least under control.

The overall default rate (that is, the percentage of outstanding loans) is four per cent per annum. Whilst this is pretty good, given the nature of the clients and the fact that commercial funders will be ahead of them in the queue for assets in the event of a business failure, it is far higher than would be desirable for commercial sources of finance. This suggests that the enterprise agencies are lending to clients who would not otherwise be able to raise finance and adds to the evidence supporting our first hypothesis.

Table 1: Summary of results

	2003	2004	2005	2006	2007
Lending					
Applications considered			42	29	47
Loans approved		77%	73%	72%	67%
Amount lent		389,000	152,200	237,100	196,500
Average loan size			7,277	10,000	7,860
Average term (yrs)			4.5	4.9	4.7
Jobs per loan		1.4	1.6	1.4	1.6
Quality of portfolio					
Portfolio yield			4.2%	5.5%	5.5%
Loan amount >90 days overdue				14%	13%
Default rates		9%	2%	5%	4%
Deployment ratio	0.3	0.48	0.47	0.54	0.54
Lending cover (years)			1.7	2.7	3.5
Revolution			0.8	0.9	0.9
Efficiency					
Capital sustainability index	0.9	0.47	1.45	1.1	1.61
Total sustainability index	0.15	0.18	0.47	0.5	0.62
Cost per pound lent		0.2	0.32	0.24	0.27
n			15	13	11

Note: figures for 2003 and 2004 cover north east England only

The deployment ratio is a measure of how much of each fund's capital is lent. The higher the ratio, the less money sitting idle, though clearly funds need to have sufficient cash available to be able to continue lending when they receive good propositions. According to the CDFA, the average deployment of CDFIs in 2007 was 68 per cent. LEAs' average deployment fell to 52 per cent in 2007, though the median was a little higher at 54 per cent, perhaps reflecting a lack of demand. The deployment ratio median is fairly constant at around 0.5. This seems low to the authors, but a number of funds have done well in raising additional funds over the last few years, and it then takes time to lend this additional money. It would seem reasonable, however, for a fund lending on three year terms to have a deployment ratio of around 0.75 (with a quarter of the fund available for making new loans, and with a quarter of the fund being repaid each year, ignoring capital losses).

Lending cover is an indication of how long (in years) the funds could keep on lending if they continued to lend and be repaid at their present rate. It is related to deployment, but also takes into account the speed (and effectiveness) with which funds are able to recover their loans. In 2007, the median was 3.5 years (up from 1.7 in 2006). So most funds do not have a

problem of insufficient monies to meet the current level of demand. The weighted mean rose from 3.6 to 5.1. This high level of lending cover suggests that there is no real need for additional funds in the near future. It also suggests that funds could be doing more to market the availability of their support. Or perhaps the fact that lending cover is rising suggests that demand for loans is falling off.

Revolution is a measure of how many times a fund has revolved its capital. Given that most funds describe themselves as revolving, it is perhaps surprising that most funds have barely lent their capital once, let alone revolved it, though the best has managed 2.1. In 2007, the median revolution was 0.9, as it was in 2006.

4.3 Efficiency

Some attempt has been made to look at the efficiency of managing the loan funds. There are differences in the way that funds record the cost of management, but it is believed that the figures are sufficiently accurate overall to make sensible comparisons. There is a wide range in the cost of running the funds. In 2005, the fund with the highest costs was spending £1.23 for each £1 lent. The inter-quartile range, which gives a better feel for the spread, showed £0.12-0.46, with a median of £0.32 and a weighted mean of £0.39. In 2006, this had improved – with a narrower spread of £0.17-0.36 and a median of £0.24. But in 2007, it deteriorated, with a spread of £0.19-0.55 and a median of £0.27. The weighted mean is up a little also, from £0.34 in 2006 to £0.37 in 2007.

One possible benchmark is the cost incurred by Provident Financial which provides so-called doorstep loans. They only provide personal lending, have none of the costs of business appraisal and have many more borrowers (and so lower costs per loan), so the figures are not directly comparable. However, it is interesting to see that in 2007, they had costs of 27p per £1 lent (see their annual report, 2008) up from 16p in 2005. Next to this, an LEA average of 0.34 looks very good.

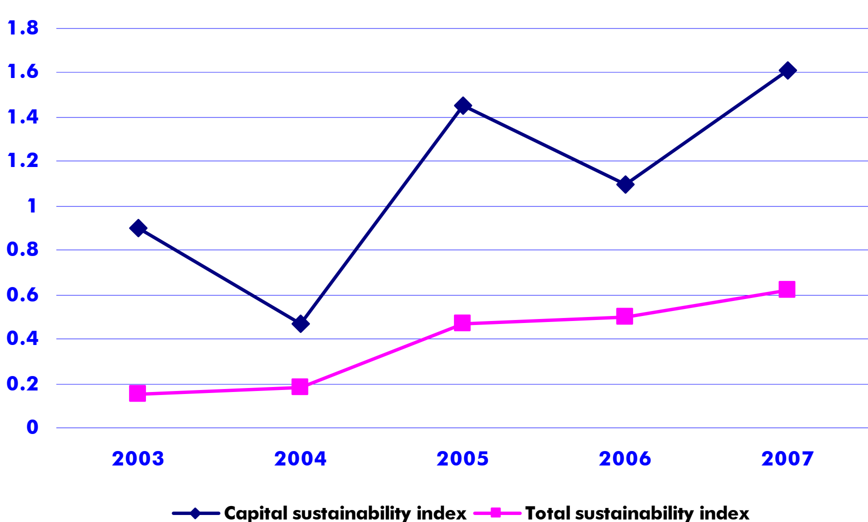
Sustainability of funds is regarded by some as important, though most enterprise agencies take the view that their loan fund is one service amongst a portfolio of services and aim to ensure that the agency overall is sustainable rather than focusing solely on the fund. However, no agency wants a fund that is a major drain on resources either. Two sustainability indices have been calculated. In both cases, a result of one means that the fund is sustainable; a figure of more than one means that it is making a surplus.

The capital sustainability index provides an indication of whether a fund can replenish its capital losses through the interest charged to borrowers together with interest earned on unlent capital. The total sustainability index looks at how close a fund is to covering all of its costs, including fund management costs and capital losses, from its income.

In 2007, the capital sustainability index median was 1.61 and the weighted average 2.24. The lower quartile was 0.94, so it would appear that most funds were able to cover their losses from the interest earned on their funds. Increasing the number and value of loans, of course, may also increase the level of delinquency and default, so it is important that agencies watch this ratio carefully. The total sustainability median was 0.62 (up from 0.47 in 2006) and the weighted mean was 0.68 (up from 0.29 in 2006). Only one agency has a index of better than 1 – and it does a very small number of loans, so is not representative. These are big improvements over 2006, but only modest improvements over the performance in 2005. It should be noted that enterprise agencies have always recognised that running a loan fund is a

drain on resources. Many believe, however, that the provision of micro-finance is a valuable component of a package of support to businesses and that, without loan finance, many clients would not be able to start in business. As hypothesised, no enterprise agency loan funds are sustainable if they are required to cover all of their losses and all of their running costs. They are becoming increasingly efficient but it is unlikely that they will be able to improve further.

Figure 2: Total sustainability



Note: the figures for 2003 and 2004 only cover micro-loan funds in the north east of England

5. Conclusions

The enterprise agencies firmly believe, and there is some evidence to support their view, that a significant number of people who would like to start in business would be unable to do so if it were not for the support available from the enterprise agencies. Some agencies have found that there is less need now than there once was to manage a loan fund as part of their portfolio of support. Meanwhile others relaunch funds, or continue to fund raise, in order to meet the demand from clients. The existence of a loan fund can help enterprise agencies to market themselves more effectively, including to people who never need to borrow from them, but who initially think that they need a loan and who certainly need other advice and support.

Whilst micro-finance is only a very small part of total lending, and enterprise agency loans, a small part of micro-finance, there does appear to be a significant number of people who would be unable to start without that support, either to provide their total external financing requirement or to leverage in commercial support. With the number of new starts growing rapidly and the micro-loan funds static or even diminishing, it would appear that loan funds are increasingly less important. However, they do still fill an important niche: providing support to businesses than cannot raise all the finance that they need from commercial sources and because, when well managed, they can have a substantial leverage effect, encouraging commercial sources to lend to businesses which they would otherwise not support. If, as society, we believe in assisting all people to achieve their potential, then the enterprise agencies – and their loan funds – still have a role to play. There is considerable, though narrowing, variation in transaction costs, which may genuinely be because some agencies are more efficient than

others, or may be because some are not attributing costs accurately. The trend in management costs appears to be downwards, which is encouraging, and is pretty good when compared to the benchmark.

There seems to be some confusion in the market place at present – with regional Business Links still settling down and with much less funding available for enterprise agencies. Indeed, some agencies barely qualify still to be members of the National Federation of Enterprise Agencies, so we might expect to see more closures and mergers, and fewer funds. Perhaps, however, the agencies also need to make more effort to promote the availability of the support that they can provide and of micro-finance. It is likely that the real need for a prospective entrepreneur is effective advice and support which will assist in unlocking the necessary financial support so the most effective micro-finance institutions, measured by survival and growth of clients, are likely to be those that can provide effective advice and support alongside their loans.

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Appendix 1: Data gathered

The table below shows the data that was gathered, both for 2007 and for the period from inception until the end of 2007. Those agencies who participated have been sent benchmarking data showing how they perform against the rest of the survey participants.

Applications Considered
Loans Offered
Loans Taken Up
Businesses Helped
Amount Offered
Amount Lent
Additional Funds Levered
Jobs Created/Maintained
Capital Repaid
Fees/ interest paid
Loans Cleared
Loans 90 days overdue
Loan amount 90 days overdue
Loans Written Off
Loan Amount Written Off
Loans approved
Jobs per loan
Annual running costs
Estimate of income on balances
Capital raised
Capital outstanding 1 Jan
Capital outstanding 31 Dec
Revenue charged to capital
Smallest loan
Largest loan
Average interest rate

Sources of capital (where not all grants)
Interest rate on borrowed monies

Appendix 2: Note on definitions

Loans approved: the ratio of loan applications approved to loan applications. This gives some indication of the effectiveness of loan funds at ensuring that they are not inundated with applications which stand no chance of success. Funds linked to advisory services are likely to require applications come with a recommendation from an adviser so one should expect high levels of conversion.

Jobs per loan: not every agency records this and in any event it can only be based on the best guess of the entrepreneur; however, given that many funds have had public money to support their funds, this provides one measure of the total impact of the funds.

Leverage: funds generally regard themselves as "lenders of last resort", so they might expect to provide the last bit of a total package, though in practice many fund have found that making the first offer can assist an entrepreneur raise the total package because it instils confidence in other lenders. Leverage represents the funds 'levered' from other sources, that is, the rest of the funding package. Leverage of 1 represents one pound from other sources for each pound lent by the fund.

Portfolio quality ratios: the research looks at two ratios which give some indication of portfolio quality: default rate and portfolio at risk. The **default rate** is defined as the percentage of the portfolio written off during the year. Historically, this has been low and has been calculated as the amount written off during the year divided by the average portfolio. The average portfolio is calculated by taking the mean of the opening capital outstanding at the beginning of the year and the closing capital outstanding at the end of the year. This year, the closing capital has been adjusted to include the written off loans and the loan amounts more than 90 days overdue, since otherwise funds that had written off large amounts during the year would have an artificially high default rate. Funds still do not have standard policies for write offs, however, so this ratio is susceptible to timing issues; it is also an indicator which lags significantly. A better measure, and one that is internationally recognised, is to use **portfolio at risk** (PAR). This is defined as the total value of loan repayments that are more than x days late. CDFA looks at repayments that 1-30 days late, 31-60 days late, 61-90 days late and >90 days late. We have just looked at repayments that are more than 90 days late. The ratio shows the repayment amounts more than 90 days overdue as a percentage of the average portfolio. PAR gives an indication of performance whilst there is time to do something about it – possibly not about individual loans, though any borrower who is late should be visited, but for revisiting the fund's overall lending policies.

Efficiency: There is a wide range in the cost of running the funds, with some funds having dedicated staff but some having only part time staff, and variation in the way that overheads are allocated. Some benchmarks look at cost per loan, but this is unhelpful where the size and number of loans varies significantly between funds. The detailed figures do report on cost per loan, but for comparison purposes, it is more sensible to look at the **cost per pound lent**. Inevitably, there will be some variation in this even for the same fund between years, but it does provide a benchmark for funds concerned about the scope to reduce the costs of running their fund.

Sustainability: Enterprise agencies, on the whole, are less concerned about creating funds which cover all of their costs, seeing their funds as one part of a total service offering. Nevertheless, it can be helpful to have a feel for the sustainability of funds and whether it is improving and no agency wants a fund that is a major drain on resources either. There are a number of ways in which this could be done; we have picked two ratios. In both cases, a result of one means that the fund is sustainable; a figure of more than one means that it is making a surplus. The **capital sustainability index** provides an indication of whether a fund can replenish its capital losses through the interest charged to borrowers and interest earned on unlent capital. It is the ratio of (fees + interest charged to borrowers + interest on unlent capital received during the period)/write offs during the period. The **total sustainability index** looks at how close a fund is to covering all of its costs, including fund management costs and capital losses, from its income. It is the ratio of (fees + interest charged to borrowers + interest on unlent capital received during the period)/(write offs during the period + running costs for the period). This ratio is the same as 'operational self-sufficiency' used by the Microfinance Information Exchange.

Portfolio yield: This year, we have introduced portfolio yield as a new measure. It is the income, that is, interest and fees generated by the fund, as a percentage of the annual portfolio. For funds that are largely grant funded, this will probably be only of academic interest, but for funds that use debt finance for on-lending, this gives can be compared with the cost of money.

Deployment: is a ratio is a measure of how much of each fund's capital is lent. The higher the deployment ratio, the lower the amount of money sitting idle, though will want to have sufficient cash available to be able to continue lending when they receive good propositions. Clearly, especially for small funds, this can be affected by a large injection of capital during the period, or a large repayment.

Lending cover: is an indication of how long (in years) the funds could keep on lending if they continued to lend and be repaid at their present rate. It is related to deployment, but also takes into account the speed (and effectiveness) with which funds are able to recover their loans.

Revolution: is a measure of how many times a fund has revolved its capital. Given that most funds call themselves revolving, this gives an indication of how good they really are at getting back and relending their capital.

The benchmarks: The detailed figures provide medians, lower and upper quartiles and means. Sometimes the comparator is given as a weighted mean. The quartiles and means are calculated by using the results from the individual agencies. For those unfamiliar with statistics, the median is the middle result, so for a response of 5 funds ranked in order, the median would be the 3rd result. If the results of PAR>90 days are 10%, 15% and 50%, then the median is 15%. The arithmetic mean takes the same results and calculates the average, in this case, 25%. For some results, however, it may be more informative to use a weighted mean, to take into account the relative size of funds. Imagine in the case of the earlier results that the fund sizes are £1,000,000, £500,000 and £100,000. This means that the total portfolio is £1,600,000. However the PAR is £185,000, giving a weighted mean of just under 12%. Where ranges are quoted, we have used the inter-quartile range, which gives the range for the middle half of respondents, and has the advantage of omitting outliers which can sometimes be extreme.

Appendix 3: Enterprise agencies

In this appendix, I list the enterprise agencies as listed in NFEA Yearbook 2007-08 together with those agencies listed as having a fund and those who responded to the survey.

	2006		2007		2008	
Agency (and location)	**Fund**	**Responded**	**Fund**	**Responded**	**Fund**	**Responded**
Airedale Enterprise Services	✓		✓		✓	
Basildon & District Local Enterprise Agency						
Bedfordshire & Luton Enterprise Agency Limited						
Birmingham Enterprise Ltd						
Black Business in Birmingham (3b)	✓					
Blackburn & District Enterprise Trust						
Bolton Business Ventures Ltd	✓	✓	✓	✓	✓	✓
Brent Business Venture						
Bristol & Avon Enterprise Agency (Brave)						
Bristol East Side Traders						
Bucks Enterprise Limited						
Burnley Enterprise Trust Limited						
Business Advice Centre (Plymouth)						
Business Advice Direct (Louth)						
Business Enterprise Centre (Hammersmith & Fulham)	✓		✓		✓	
Business Enterprise Support Limited (Burton on Trent)	✓	✓				
Business Extra Limited (Southwark)						
Business Focus (Bromley)						
Business Initiative (Stoke on Trent)						
Business Link Coventry & Warwickshire						
Business Link Gloucestershire						
Business Support & Development Limited (Bedale)						
Cambridgeshire Enterprise Services Limited						
Cariocca Enterprise Manchester Limited						
Centa Business Services (Central London)						
Centre for Enterprise (Leicester)						
Chester & Ellesmere Port Enterprise Limited						
Chester Le Street & City of Durham EA Limited						
Colchester Business Enterprise Agency Ltd (COLBEA)						
Croydon Business Venture Limited						
Cumbria Rural E A Limited						
Darlington Business Venture	✓					
Derbyshire Enterprise Agency						
Derwentside Industrial Development Agency						
DONBAC Limited	✓	✓	✓		✓	
East Durham Business Service						
East London Small Business Centre	✓	✓	✓	✓	✓	✓
East Riding of Yorkshire Council						
Eastbourne & District Enterprise Agency Limited	✓					
Enterprise Agency of North Kent	✓	✓	✓	✓		
Enterprise Agency of West Kent						
Enterprise Cornwall			✓		✓	

	2006		2007		2008	
Agency (and location)	**Fund**	**Responded**	**Fund**	**Responded**	**Fund**	**Responded**
Enterprise Enfield	✓	✓	✓	✓	✓	✓
Enterprise Fenland						
Enterprise First (Aldershot)						
Enterprise Plymouth Limited	✓	✓	✓			
Enterprise South Devon	✓					
Enterprise Tamar Limited						
Erewash Partnership	✓					
First Enterprise Business Agency Limited (Nottingham)	✓		✓	✓	✓	✓
Five Lamps			✓		✓	
Furness Enterprise Limited	✓	✓	✓	✓	✓	✓
Great Western Enterprise	✓		x		x	
Grimsby & Cleethorpes Area Enterprise Agency Ltd	✓		✓		✓	
Haringey Business Development Agency						
Harrogate & Craven Business Development Centre Ltd						
Harrow In Business						
Harrogate & Craven Business Development Centre						
HBV Enterprise	✓		✓		✓	
Heart of Devon Enterprise Agency						
Hull Area Business Advice Centre Limited						
Hyndburn Enterprise Trust						
InBiz Limited			✓		✓	
Ipswich & Sudbury Enterprise Agency Limited						
Isle of Wight Enterprise Agency	✓	✓	✓	✓	✓	
Islington Enterprise Agency						
Kent Invicta Chamber of Commerce						
Kettering Business Venture Trust						
Manchester Business Consortium Ltd						
Mansfield Sutton & Kirby Enterprise	✓		✓		✓	
Mid Anglian Enterprise Agency Limited						
Mid Cornwall Enterprise Trust Limited	✓					
Mid Essex Enterprise Agency						
Newark Business Venture	✓					
Norfolk & Waveney Enterprise Services	✓	✓	✓	✓	✓	✓
North Devon Enterprise Agency Limited						
North East of England Business & Innovation Centre	✓	✓	✓	✓		✓
North Somerset Enterprise Agency	✓		✓		✓	
North Yorkshire Moors & Coast Business Advice Agency						
Northamptonshire CDA Limited						
Northern Pinetree Trust		✓	✓		✓	
Norwich Enterprise Agency Trust						
Nottinghamshire Business Venture	✓		✓		✓	
Nottinghamshire Enterprises						
oneLondon Limited	✓	✓	✓			
Oxfordshire Business Enterprise Limited						

	2006		2007		2008	
Agency (and location)	**Fund**	**Responded**	**Fund**	**Responded**	**Fund**	**Responded**
Pendle Enterprise Trust Limited						
Portobello Business Centre	✓		✓		✓	
Preston Business Venture Limited						
Project North East	✓	✓	✓	✓		
Ribble Valley Enterprise Agency						
Rotherham Enterprise Agency Limited						
Salford Hundred Venture						
Scarborough Enterprise Agency						
Sedgefield Borough Business Services (SASDA)			✓		✓	
Sheffield Enterprise Agency	✓					
Shepway Enterprise Agency						
Sirius (Saltend Community Development Co Ltd)	✓	✓	✓		✓	✓
Small Business Counselling Service (Milton Keynes)						
South East Northumberland Enterprise Trust	✓	✓	✓		Merged PNE	
South Hampshire Enterprise Agency						
South Humber Business Advice Centre Limited						
South Ribble Business Venture						
Southend Enterprise Agency Limited			✓		✓	
St Albans Enterprise Agency (STANTA)						
St Helens Chamber						
Stafford Enterprise Limited						
Stevenage Business Initiative						
Surrey Business Advice						
TBV Business Services (Timperley)						
Technology Enterprise Kent						
Teesdale Enterprise Agecny						
Ten Sixty Six Enterprise Limited (Capitalise)	✓		✓	✓	✓	✓
Brighton, Hove and Lewes Enterprise Agency						
Greenwich Enterprise Board						
Innovatory (London)						
TNG Business Support (Enfield)	✓					
Train 2000			✓		✓	
Tyne & Wear Enterprise Trust Limited						
Tyneside Economic Development Co Limited	✓		✓		x	
Warrington Business Venture	✓					
Wear Valley Development Agency						
Welland Enterprise Agency	✓					
WENTA Business Services	✓					
West Cumbria Development Agency Limited			✓		✓	
West Devon Business Information Point Limited						
West Sussex Area Enterprise Centre						
West Yorkshire Enterprise Agency	✓	✓	✓	✓	✓	✓
Whitby & District Business Development Agency Ltd						
York Business Advice Centre			✓	✓		
York Selby & Malton BAC Ltd	✓		✓		✓	

Appendix 4: Detailed figures

Table 1: LEA loan funds – efficiency indices

	Serious applications	Loans approved	Amount lent (in year)	Total outstanding	Loan sizes	Jobs per loan	Loan amount > 90 days overdue	Default rates
2007								
Lower quartile	28	60%	126,000	278,000	6,000	1.29	5%	2%
Median	47	67%	197,000	651,000	7,900	1.56	13%	4%
Upper quartile	65	77%	409,000	991,000	16,000	2.44	19%	6%
Total	520	68% (mean)	3.8m	11.5m	10,600 (mean)	1.87 (mean)	15% (mean)	5% (mean)
2006								
Lower quartile	9	63%	35,000	278,000	5,500	1.23	5%	1%
Median	29	72%	237,000	527,000	10,000	1.42	14%	5%
Upper quartile	79	89%	411,000	1.147m	13,400	1.71	39%	8%
Total	613	74% (mean)	4.1m	10.03m	10,000 (mean)		12% (mean)	4% (mean)
2005								
Lower quartile	28	60%	77,000	77,000	3,900	1.24		0%
Median	42	73%	152,000	302,000	7,300	1.6		2%
Upper quartile	78	83%	439,000	576,000	12,000	2.54		11%
Total	805	67% (mean)	4.6m	11.6m	9,500 (mean)			5% (mean)

Table 2: LEA loan funds – efficiency indices

	Cost per pound lent	Capital sustainability index	Total sustainability index	Deployment ratio	Lending cover (years)	Leverage	Revolution
2007							
Lower quartile	0.19	0.94	0.31	51%	1.9	0.5	0.6
Median	0.27	1.61	0.62	54%	3.5	1.7	0.9
Upper quartile	0.55	2.72	0.95	60%	7.7	1.8	1.3
Weighted mean	0.37	2.24	0.68	52%	5.1	1.5	1.0
2006							
Lower quartile	0.17	0.52	0.26	48%	2.0	0.4	0.6
Median	0.24	1.10	0.50	54%	2.7	1.8	0.9
Upper quartile	0.36	2.51	0.87	66%	4.4	2.0	1.0
Weighted mean	0.34	2.00	0.60	56%	3.6	1.3	0.9
2005							
Lower quartile	£0.12	0.57	0.17	37%	0.9	0.6	0.6
Median	£0.32	1.45	0.47	47%	1.7	1.1	0.8
Upper quartile	£0.46	2.24	1.1	57%	3.0	2.4	1.0
Weighted mean	£0.39	2.4	0.7	51%	2.8	1.6	0.9