Community Finance Solutions

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LLOYDS TSB OPERATIONAL SUSTAINABILITY RESEARCH PROJECT – FINAL TECHNICAL REPORT

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EXECUTIVE SUMMARY

Introduction

This document presents the conclusions and recommendations of the Lloyds TSB Operational Sustainability Research project. The project aims to enhance the operational and financial performance of the Community Development Financial Institution (CDFI) sector and assess the overall profitability and sustainability of the industry through an in-depth analysis of five UK CDFIs perceived to be market leaders.

Study context and methodology

Becoming more financially and operationally sustainable is a question of paramount importance for CDFIs and their funders, particularly due to the uncertain funding context in the UK. Furthermore, by capitalising on the longevity of operations through product and process innovation, a CDFI may enter into a virtuous circle of improvements in operational sustainability.

Previous research into the UK CDFI sector has identified three pathways of improving financial and operational sustainability:

- A diverse and balanced loan portfolio may protect against changes in funding and other circumstances impacting upon certain products;
- Enhancing staff efficiency and productivity constitutes a key way to reduce costs and increase revenue without passing on costs to the customer; and
- Effective partnerships can increase the customer base through marketing and referrals, reduce costs by transferring them to the partner organisation and by accessing funding

This study analyses how five leading UK CDFIs perform in these three areas through an in-depth analysis of the performance of their loan portfolio, of their partnerships and of the way in which their staff members spend their time and the processes and structures driving this time-use.

Loan portfolio analysis

The loan portfolio analysis suggests that the CDFIs are some way away from covering their costs exclusively through the income generated from their loan portfolios. The most sustainable CDFIs in the sample are able to cover just over 60% of their costs through interest rates, fees and bank interest earned. Four out of the five CDFIs in our sample either come close to or surpass the performance of Aspire in Ireland and Street UK. Three of the CDFIs also perform better than the average performance of the UK CDFI sector according to the latest CDFA industry survey.

The results of the financial modelling indicate that over time the CDFIs are improving their performance even if they make no changes to the way they operate. However, the CDFIs can, depending on their starting point and mix of products, make considerable improvements by adjusting interest rates and fees, and by increasing productivity. However, we also found that high overhead costs relative to activity earnings (interest income from bank deposits, income from interest and fees earned) can act as a break on sustainability.

The financial sensitivity analysis of future capital requirements and different models of recapitalisation suggests that raising loan capital purely through recycling existing funds is an unviable strategy to fund future expansion of the CDFIs in the sample.

Already in the first year of operation without granted or borrowed loan capital even the most sustainable CDFIs experience considerable funding shortages.

Whilst borrowing capital for on-lending is, ceteris paribus, likely to lead to a decline in sustainability, two of the CDFIs may be able to borrow as much as 30 and 60% of their future capital requirements and still reach full sustainability by year 7 – providing the CDFIs raise interest rates and loan officer productivity, and introduce the home improvement loan.

Staff efficiency and productivity

The analysis of the way in which CDFI staff members spend their time suggest that there are striking differences in the productivity of the CDFIs in the sample. The prime indicator of this is that a personal loan officer at the most efficient CDFI grants 440 personal loans per year, which is more than twice as many as a loan officer at the least productive CDFI and more than 100 loans more than the second most productive CDFI in the sample.

The data suggest that there are three factors driving productivity. First, we found a strong relation between the time the lending staff spent on direct customer contact and loan officer productivity. Provided there is sufficient demand for the products of the CDFI, by organising the non-lending in such a way to maximise the exposure of the lending staff and by allowing non-lending staff to step in for interviews when necessary, the CDFI can raise the loan officer productivity considerably. Further, our findings further suggest that part of maximising lending staff exposure to potential customers also lies in outsourcing administrative aspects of arrears control and possibly other areas to external companies

Second, we also found that the loan officer productivity is crucially linked to the proportion of repeat clients. The CDFI which displayed the greatest loan officer productivity also had the greatest proportion of repeat clients. Repeat business involves lower transactions costs and generally constitutes a smaller risk for the CDFI.

Finally, the number of applicants a loans officer can interview is to some extent conditional on the availability of appropriate meetings rooms. For example, in the case of CDFI B, two loans officers and two debt advisors share one meeting room, which may limit the number of loan applicants a loans officer can see in the course of a working day. That said, unless the CDFI is able to generate sufficient demand for its products and put in place efficient processes to deal with this demand, investing in appropriate premises alone is unlikely to be sufficient to boost productivity.

Partnership effectiveness

The primary partner organisations of the CDFIs in the sample are local governments, housing associations and, banks and building societies. The cooperation mainly centres on marketing, funding and making referrals to the CDFIs. Many of the local authorities also cooperate with the sector on the provision of home improvement loans.

On the whole, the partner organisations perceive the CDFIs to be reliable and trustworthy partners, while there is less consensus on the degree to which their partnership is effective and helps them achieve their goals. Local authorities appear most uniform in the extent to which their partnerships with the CDFIs are formalised, in their knowledge of loan products and processes and generally display the highest level of satisfaction.

Recommendations

Our research suggests that many of the levers to enhance the sustainability and viability of the CDFI sector are in the hands of the CDFIs themselves. They can grow their loan books through marketing, effective partnerships and appropriate product design, they can cut costs through improving the efficiency with which certain products are delivered, they can add new products and they can increase interest rates and increase or introduce administration fees.

In particular, our findings suggest that there are certain structural and process-related changes which are likely to have a particularly positive impact on the sustainability of the CDFI sector:

1. Charge interest rates which more closely reflect the costs involved in providing loans
2. Take steps to maximise lending staff's exposure to potential customers in order to boost loan officer productivity
3. Capitalise on links with other CDFIs to enhance innovation and reduce costs
4. Make the case for developmental rather than only sustaining funding

However, funders and policy-makers also have a great role to play in shaping the future prospects of the CDFI sector. In particular, we believe that funders can underpin the future sustainability of the sector by offering:

1. Development grants to stage-manage productivity improvements
2. Development grants to launch new products

The results of the financial sensitivity analysis of the different recapitalisation models show that the sector's further expansion is dependent on capital being made available in the form of capital grants and loan finance. Depending on the level of maturity and sustainability of the individual CDFIs, funders can strengthen the lending capacity of the CDFI sector through offering:

3. Capital grants for loan capital
4. Loan finance for on-lending
5. Capital/guarantee to underwrite bad debts

Glossary

BERR	Department for Business, Enterprise and Regulatory Reform
CDFA	Community Development Finance Association
CDFI	Community Development Financial Institution – independent organisation lending and investing in deprived areas and underserved markets without access to mainstream finance
CFS	Community Finance Solutions
CGAP	Consultative Group to Assist the Poor
Change matters	Financial, social and operational performance benchmarking and industry survey designed and conducted by the CDFA
CRT	Community Reinvestment Trust
DWP	Department of Works and Pension
DTI	Department of Trade and Industry (now BERR)
Growth Fund	Fund of £36 million fund set up by DWP in 2004 to increase availability of affordable personal loans via third sector (not-for-profit) lenders (e.g. CDFIs and credit unions)
MFI	Microfinance Institution
Phoenix Fund	Fund set up by BERR (then DTI) in 2000 to support innovative demonstrator projects working in disadvantaged areas. It benefited 62 CDFIs with £42.5 million in capital and revenue funding
RDAs	Regional Development Agencies
SME	Small and Medium Business

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Finally, we are indebted to the management and staff at the participating CDFIs as well as their partner organisations for sharing their knowledge, experiences and innovative practices with the research team.

1 INTRODUCTION

The present document is the final technical report for the Lloyds TSB Operational Sustainability Research Project. The purpose of the report is to present the findings and recommendations of the research project. The Operational Sustainability Research project aims to enhance the operational and financial performance of the Community Development Financial Institution (CDFI) sector and assess the overall profitability and sustainability of the industry through an in-depth analysis of five UK CDFIs perceived to be market leaders.

The remainder of the report is organised into 5 sections:

- *Section 2:* Study context and methodology
- *Section 3:* Staff efficiency and productivity
- *Section 4:* Effectiveness of partnerships
- *Section 5:* Loan portfolio analysis
- *Section 6:* Conclusions and recommendations

2 STUDY CONTEXT AND METHODOLOGY

2.1 Introduction

Internationally, the sustainability of the community finance sector has been subject to considerable polemic and research in the past 40 years (e.g. Adams, 1972; Adams and Von Pischke, 1992; New Economics Foundation, 2004; Schreiner and Yaron, 1999). Much of this debate has centred on the degree to which the sector is operationally and financially sustainable.

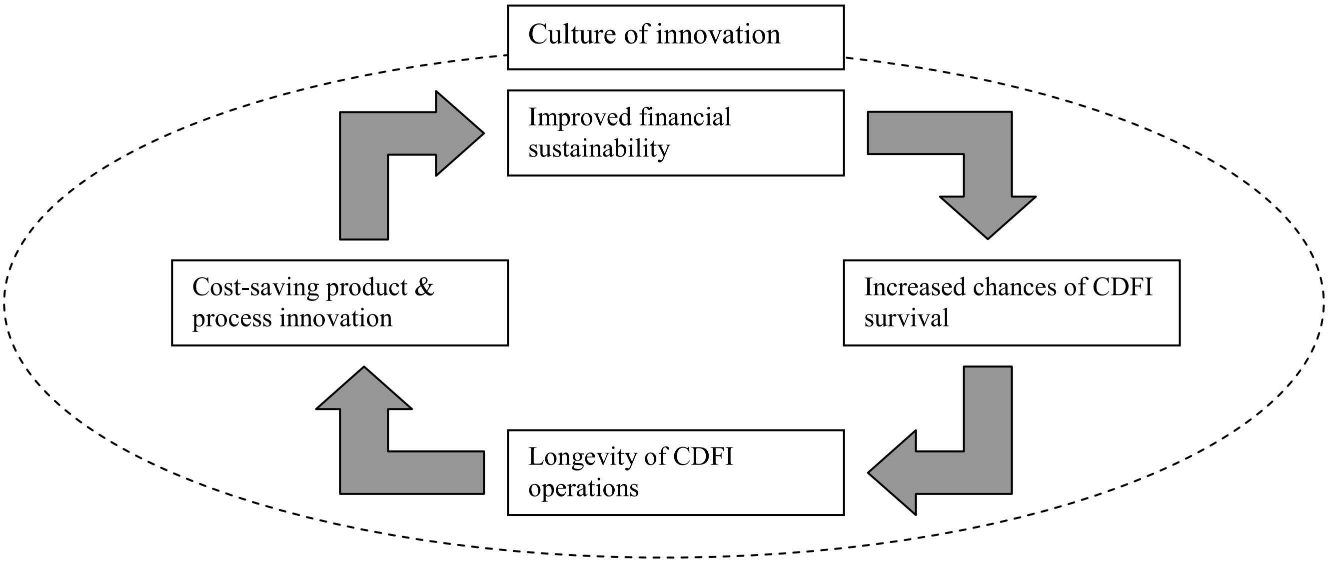
Operational sustainability generally refers to the ability of a CDFI to cover its revenue costs with income from its core activities (i.e. fee and interest rate income from its loan portfolio) (CGAP, 2003; CDFA, 2006b). Financial sustainability refers to the ability of a CDFI to cover its costs if it had to raise 100% of its loan portfolio through recapitalisation and through borrowing funds at the market rate (CGAP, 2003; CDFA, 2006b).

Becoming more financially and operationally sustainable is a question of paramount importance for the CDFIs and their funders. The end of the Phoenix fund and the transfer of responsibility for Small and Medium Enterprise (SME) development to Regional Development Agencies (RDAs) have put in question the nature and magnitude of future funding of the sector (Anon, 2007; McGeehan, 2006).

Enhancing the ability of CFDIs to cover their operating costs is likely to strengthen the sector's ability to withstand potential funding shortages. The ability of a CDFI to cover its operating costs is not only an indication of the sector's ability to withstand potential funding shortages, but it is also a relatively cheap and reliable measure of cost-effectiveness of CDFIs in promoting financial inclusion.

Further, if successful in becoming more financially and operationally sustainable, a CDFI may enter into a virtuous cycle of further advances towards operational self-sustainability (Figure 1). The greater extent to which a CDFI can cover its own expenses, the greater chance it has at surviving. The resulting longevity of operations may allow for greater experimentation and product and process innovation. This in turn may result in greater advances in financial sustainability. Only CDFIs with an innovative organisational culture is likely to enter into such a virtuous circle as indicated by the stippled line surrounding it.

Figure 1: Virtuous circle of improving financial sustainability



Research on the UK CDFI sector (Forster et al, 2004; New Economics Foundation, 2004; Dayson, 2005; Dayson, 2006) suggests that there are three pathways through which the industry can improve its financial and operational performance.

2.2 Improving staff efficiency and productivity

Despite limited research in this field, the way in which CDFIs use their employees may be of considerable importance for the performance of the sector (Dayson, 2005). Crucially, it is an important way to reduce costs and increase revenues without passing on the costs to the customer in the form of increased interest rates and other fees. Particularly in the case of personal loans, reducing time spent per loan is important to reduce costs.

In addition, such exercises may highlight important added-value in the form of services they offer in addition to loans. Previous research by Community Finance Solutions (CFS) revealed that CDFI employees spend considerable time on money and debt advice to unsuccessful loan applicants (see Dayson, 2005)

2.3 Creating and enhancing partnerships

As CDFIs often lack the infrastructure and financial capacity to service all their needs, partner organisations could potentially play an important role in increasing lending and reducing operating costs in numerous ways.

First, partnerships can increase the number of clients through marketing and referrals. Referrals are an important source of potential customers, particularly for business lending. The then specialised business lender, Street UK growth was seriously hampered by the lack of referrals from banks and business organisations owing to lack of partnerships (New Economics Foundation, 2004).

Marketing their products to potential clients is a vital activity for CDFIs in order to reach a large pool of customers. However, marketing campaigns, such as TV and newspaper adverts and canvassing target markets, can be very costly. Moreover, reaching a small audience, often distrustful of financial marketing, can be difficult. Housing associations, job centres and other organisations may offer the CDFIs channels to pools of potential clients.

Second, partnerships can potentially lead to a reduction in costs by transferring them to the partner organisation. For example, costs may be reduced if agencies and organisations making referrals do preparatory work, such as ensuring that clients have appropriate identification papers or helping them complete a loan application form before visiting the CDFI. Third, in order to retain and gain funding, it is crucial that the CDFI has a positive image and that it manages its external relations effectively.

2.4 Offsetting and producing a balanced loan portfolio

A mixed and balanced loan portfolio, consisting of business loans and home improvement loans as well as personal loans, may prove important in producing a more resilient and sustainable CDFI sector. Research into the performance of other CDFIs, such as Aspire and Street UK, has cast doubts on the viability of specialised CDFIs (Forster et al, 2006; New Economics Foundation, 2004).

First, the size of the potential market for UK CDFIs is limited. Unlike in the Developing world, exclusion from mainstream finance in industrialised countries is a marginal phenomenon. Approximately, 10% of UK households live on the periphery of main-stream financial services (HM Treasury, 2004), and it is estimated that there are around three million users of alternative credits in the UK (HM Treasury, 2004; Drakeford and Sachdev, 2001). In turn, only a proportion of these households are likely CDFI customers.[1]

Second, specialised CDFIs may prove more vulnerable to changes in the funding priorities of changing governments as well as structural changes affecting demand for certain products. By offering a range of products, the CDFIs may diversify and spread risks, possibly making them more resilient to changing circumstances. By balancing risk and profit in this way, there is a possibility for cross-subsidising of certain products, indefinitely or in periods. This has particular implications for personal loans which are characterised by slender or negative profit margins, owing to small loan amounts and resource-intensive properties.

The findings of the CDFA 2005 Inside Out industry survey certainly seem to suggest that there is a trend towards income and portfolio diversification among UK CDFIs (McGeehan, 2006).

2.5 The participating CDFIs

In total, five CDFIs in the UK are participating in this study. Given the sensitive nature of some of the data and findings presented in the report, the CDFIs are not referred to by their real names. Instead we assign the letters A to E to them. Table 1 summarises the business models of the CDFIs in the sample and their key features, including size (number of branches, value of loan etc), areas of operation, products offered and business planning (areas of expansion, contraction etc). This is important contextual information which helps in the interpretation of the results of the analyses in the subsequent sections.

[1] The manager of one of the CDFIs in the sample estimates that only about 25% of the home credit market constitutes a viable and desirable market for the CDFI sector.

Table 1: The CDFIs studied

	CDFI A	CDFI B	CDFI C	CDFI D	CDFI E
Number of employees (FT positions)	10	12	5	11	5
Total value OLP (£ '000)*	951'	202'	554'	444'	520'
Financial products (% of OLP)	PL (74) BL (26)	PL (37) BL (34) SEL (29)	PL (54) BL (46)	PL (58) BL (41) HIL (1)	HIL (100)
Loans granted by product	PL: 1262 BL: 78	PL: 202 BL: 46 SEL: 2	PL: 310 BL: 23	PL: 562 BL: 41 HIL: 4	HIL: 89
Other services	SP	DMA	..	DMA	..
Branches	3	2	2	2	1

Source: Loan portfolio data provided by the CDFIs for the financial year of April 2006 to March 2007
Notes: * Assessed on March 31 2007
Abbreviations: PL = Personal loans, BL = Business loans, SEL = Social Enterprise Loan, HIL = Home Improvement Loans, SP = Savings products, DMA = Debt and Money Advice, FT = Full-time, OLP = Outstanding loan portfolio, SC = Subcontract

Whilst all CDFIs were created based on the Community Reinvestment Trust (CRT) model to offer a one-stop shop for the financially excluded, the CDFIs operate based on different business models.

Four of the CDFIs have personal lending as their core activity based on the proportion of outstanding loan portfolio. These are CDFI A, CDFI B, CDFI C and CDFI D. CDFI A has the largest personal loan portfolio both in terms of number and total value of loans granted. Starting in the financial year of 2007-2008, the CDFI plans to exclusively focus on the delivery of personal loans. CDFI A operates in areas with large groups of the population at the margins of mainstream finance evenly spread allowing for large-scale personal lending. Indeed, CDFI A has a deliberate expansion strategy targeting such areas.

CDFI C, the smallest of the personal lending CDFIs, operates in similar areas to CDFI A, but has a considerably smaller portfolio. In addition, the CDFI is also moving towards greater specialisation in personal lending with considerable expected growth rates, whilst the business loan portfolio is expected to remain stagnant in terms of the number of loans granted.

Conversely, CDFI D and, to a lesser extent, CDFI B operate in areas where there are pockets of social and financial exclusion among more affluent areas making it more difficult to reach an appropriately large scale in personal lending. Thus, CDFI D has the most diverse portfolio offering home improvement loans, personal and business loans as well as debt and money advice. In particular, the CDFI aims to expand its home improvement loan portfolio, whilst scaling down its personal loan portfolio. Similarly, CDFI B offers money advice and social enterprise, business and personal loans. However, unlike CDFI D, CDFI B has set ambitious growth targets for its personal loan portfolio.

CDFI E is the only non-consumption lender in the sample. As the CDFI with the longest track record of delivering home improvement loans, CDFI E serves as a point of reference for long-term performance of the product and for administrative and technical requirements for introducing the home improvement loan.

2.6 Methodology

To be able to analyse the performance of these CDFIs in the three fields set out in the preceding section (staff efficiency and productivity, effective partnerships and a balanced and profitable loan book) we use a range of methods and draw on information from numerous sources.

The methodological approach used in the analysis of staff efficiency and productivity attempts to answer four questions:

- How do the CDFIs spend their time?
- How do the different staff groups spend their time (administrators, managers and loans officers)?
- How does the use of time differ across the different CDFIs?
- What are the factors, especially organisational structures and procedures, determining staff efficiency and productivity?

The analysis of staff productivity and efficiency draws on data and qualitative information from three sources:

- Daily timesheets filled in by CDFI employees between June 25 and July 13, 2007
- Qualitative interviews with 16 employees across the CDFIs
- Secondary sources concerning the financial products and operation of CDFIs

In addition to recording minutes spent on tasks (e.g. loan interviews, opening up of loan accounts), loans officers were asked to record number of loan applicants seen. Based on the latter data, we were able to make estimations about annual loan officer productivity, which in turn fed into the loan portfolio analysis.

The analysis of the partnerships formed by the CDFIs focuses on the three potentially performance-enhancing aspects of partnerships: increasing customer base (through referrals and marketing), transferring costs and accessing funding. Specifically, this analysis attempts to answer the following questions:

- How effective are partnerships in increasing the customer base of the CDFIs through referrals and marketing?
- How do partner organisations perceive the CDFIs and their partnership in terms of value-for-money and reliability?

In order to answer these questions, the partnership analysis drew on findings from a statistical analysis of data from an online partnership questionnaire.

Finally, the methodology applied in the analysis of the loan portfolio will attempt to answer the following research questions:

- How sustainable are the CDFIs currently? To what degree are they able to cover their costs with operating revenue (interest rates, fees, etc)?
- What gains can the CDFIs make over the next 7 years? What are the most effective tools in boosting operational sustainability: interest rates, product mix or loan officer productivity?

To be able to answer these questions, the following data was collected and analysed for business loans (including social enterprise loans), personal loans and home improvement loans for the financial year of April 2006 to March 2007:

- Size of loan book (number of loans, value of loans)
- Income from interest rates and fees
- Staff and overhead costs for delivery
- Loans written off, arrears and capital at risk
- Capital available to lend (including sources of funding, e.g. DWP)

2.7 *Existing research on operational sustainability – the CDFA Performance Framework*

Related research into operational sustainability is also currently being conducted by the trade association, the Community Development Finance Association (CDFA). The CDFA, with funding from Friends Provident Foundation, is currently in the process of developing a CDFI performance framework. This is known as Change Matters which is a financial, organisational and impact monitoring and assessment tool based on the three key areas of finance, business operations and impact. The CDFA has developed a draft framework with a total of 40 performance framework headings, has conducted site visits and has held member and stakeholder consultation. It plans to launch final industry benchmarks in March of 2008.

While there is a degree of overlap between the CDFA framework and the Operational Sustainability Research Project, there are significant differences between the two approaches. First, Change Matters is an industry survey intended to be a continuous monitoring and benchmarking tool for the CDFI sector and its supporters. Conversely, our research project is intended to be one-off, focusing on the performance of five CDFIs at one point in time. That said the CDFIs will be given a financial sensitivity analytical tool which they may use in future financial planning.

Second, Change Matters is more extensive in its coverage. It includes indicators for social impact, marketing, outreach and governance, and it is a survey of the whole sector, whereas our research focuses exclusively on operational sustainability among five leading UK CDFIs. The benefit of our study is that it allows for more in-depth and detailed research, and we are in a position to offer specific technical advice and recommendations to the participating CDFIs.

Third, the Lloyds TSB Operational Sustainability Research Project also analyses in detail issues that are not covered by Change Matters. Our financial analysis does not focus exclusively on the overall sustainability, but looks at the earning potential for each financial product and how this affects the overall performance.

Further, we have also conducted an in-depth analysis of the use of time among CDFI employees to determine staff efficiency and productivity. Whilst the CDFA framework contains some indicators of productivity, Change Matters does not cover the use of time among CDFI staff and does not identify key bottlenecks or efficiency draining tasks. Finally, our work assesses the effectiveness of partnerships. Partners may be an important source of revenue funding and new customers in the form of referrals. They may also serve as cost-effective marketing channels.

The outcomes of the Change Matters framework and the Lloyds TSB Operational Sustainability Research Project are expected to be mutually beneficial. The findings of CDFA's industry survey will give us the opportunity to compare the performance of the CDFIs in the sample with overall trends in the sector. Similarly, it is hoped that the findings of our in-depth study of CDFIs, seen to be innovative and leading in their areas, will enhance CDFA's understanding of operational sustainability.

3 STAFF EFFICIENCY AND PRODUCTIVITY – THE USE OF TIME AMONG CDFI EMPLOYEES

3.1 Introduction

This chapter analyses how administrators, managers and loan officers across the CDFIs spend their time. Ultimately, the efficiency and productivity of CDFI employees may determine its capacity to generate sufficient income to cover its costs. Crucially, enhancing the productivity and efficiency of staff members is a way of increasing revenue without passing on the cost to the customer.

The greater efficiency with which non-core or sustaining activities is executed, the more time may be spent on generating income through growing the loan book and on reducing loan losses through monitoring and debt collection. In turn, these core activities may be executed with greater efficiency, reducing costs and increasing revenue.

Specifically, drawing on staff timesheets, qualitative staff interviews and supplementary information, this chapter attempts to answer four questions:

- How do the CDFIs spend their time?
- How do the different staff groups spend their time (administrators, managers and loans officers)?
- How does the use of time differ across the different CDFIs?
- What are the factors, especially organisational structures and procedures, determining staff efficiency and productivity?

Staff efficiency and productivity is not wholly a product of the way in which the CDFIs organise their staff or the ways in which loans, loan applications, reports, monitoring and other tasks are dealt with. Thus, the analysis attempts to take into consideration numerous caveats, including:

- *Loan portfolio mix:* Financial products may differ in time and resource intensity, profitability and risk
- *Client group and locations:* Client groups and locations may differ in terms of time and resource intensity of service delivery, profitability and risk
- *Organisational structure and size:* In larger organisations costs may be reduced through allowing for economies of scale
- *Age of CDFI:* Older CDFIs may have had a longer time to put in place and improve mechanisms although conversely the older CDFIs may suffer having been the "guinea-pigs" and have adopted systems which may have proved less than ideal, enabling newer entrants to benefit from their experiences

Table 2 displays the number of staff members participating in the timesheet exercise by staff group. The response rate was very high and the staff members were very cooperative. In total 48 out of a total of 51 staff members submitted timesheets. Two loans officers and a manager from CDFI A were unable to participate. In addition, we conducted semi-structured interviews with 16 members of staff from the 5 CDFIs.

Table 2: Participating staff members

	CDFI A	CDFI E	CDFI C	CDFI D	CDFI B	Total
Total staff	7	5	6	11	6	**48**
Admin	2	1	1	2	1	**7**
Lenders	3	3	3	6	3	**18**
Management	2	1	2	3[2]	2	**10**

In addition to non-participating staff members, several staff members were on leave for parts of the time period. In some CDFIs a disproportionate number of loan officers were on leave, while a greater number of managers were on leave in others. To ensure that these issues would not result in skewed results, we weighted the data according to the normal distribution of staff across the staff categories. The exception to this is CDFI E where none of the staff members were on leave in the time period in question. Otherwise, all reported data are weighted. Where this is thought to have affected the accuracy of the data it is noted.

Table 3 displays the number of full-time positions by staff group and CDFI. The 51 staff members – including the three non-participating staff members – work an equivalent to 32.3 full-time positions.

Table 3: Distribution of full-time positions across staff groups

	CDFI A	CDFI B	CDFI C	CDFI D	CDFI E	Total
Total staff	7.5 (100)	5.55 (100)	4.75 (100)	10 (100)	4.5 (100)	32.3 (100)
Admin	1.5 (20.0)	0.75 (13.5)	0.8 (16.8)	1.75 (17.5)	0.5 (11.1)*	5.3 (16.4)
Lenders	3.5 (46.7)	3.0 (54.0)	1.95 (41.1)	5.45 (54.5)	3.0 (66.7)	16.9 (52.3)
Management	2.5 (33.3)	1.8 (32.3)	2.0 (42.1)	2.8 (28.0)	1.0 (22.2)	10.1 (31.3)

Notes: Percentages are given in brackets.
* The admin person does not work a set amount for CDFI E, but instead splits her time between CDFI E and its mother organisation. During the timesheet exercise the number of hours worked on CDFI E were equivalent to a part-time position of 50% (based on a work week of 35 hours)

There are striking similarities in the staff structure across the different CDFIs, particularly across the personal lending CDFIs. To run a CDFI, a minimum of one full-time administrator position, three full-time loan officer positions and two full-time manager positions seem to be required. Further, a comparison of the largest (CDFI A and CDFI D) with the smallest CDFIs (CDFI B and CDFI C) suggests that an expansion of operations requires the expansion of support roles, in the form of management and administration, as well as lending roles, or to consider using the services of outsourcing agencies.

3.2 The findings

Before turning to the analysis, it is important to highlight that CDFI E differs from the other institutions in many respects because it focuses exclusively on the delivery of the home improvement loans as opposed to personal loans. Therefore, in most of the tables, the averages for the personal lending CDFIs will be displayed and much of the analysis will centre on differences and similarities in the use of time between these CDFIs. CDFI E conversely will be used as a benchmark for the delivery of home improvement loans.

[2] CDFI D's outreach worker is here included as a manager. The timesheet data of this staff group is only included in the analysis of the use of time of the organisation as a whole.

Table 4 displays the weighted timesheet data according to activity by CDFI for all staff members. Each activity consists of numerous tasks. For example, making loans consist of loan interviews, reviewing application, issuing of loan and loan administration. A key distinction made is the distinction between the time spent on sustaining activities – tasks not easily linked to the provision of financial products – vs. time spent on core activities directly linked to the provision and monitoring of loans.

Table 4: Proportion of time spent by all staff by CDFI (% of productive time)

	CDFI A	CDFI B	CDFI C	CDFI D	Average score	CDFI E
Loan enquiries	7.1	2.5	8.0	3.5	**5.3**	0.4
Money advice	1.9	0.3	0.8	0.1	**0.8**	0.5
No shows	2.7	0.1	0.0	1.0	**1.0**	0.1
Making loans	31.4	33.7	21.9	29.2	**29.1**	39.1
Month-end reports	4.3	1.7	4.6	2.2	**3.2**	1.3
Servicing loans	2.7	2.4	5.1	3.8	**3.5**	0.7
Delinquency control	7.9	10.0	13.3	12.6	**11.0**	2.6
Promotional activities	3.5	9.7	11.5	17.0	**10.4**	14.4
Office management	36.6	36.9	33.9	29.1	**34.1**	37.1
Other activities	1.9	2.7	0.9	1.5	**1.8**	3.8

Notes: Reported as percentages based on weighted data
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Three tasks categories take up almost all of the time for CDFIs. Sustaining activities – promotional activities and office management combined – stand out as the single most time-consuming task for all CDFIs, accounting for between 40 and 45% if total productive time. Tasks relating to office management constitute the single biggest activity for all the personal lending CDFIs with the exception of CDFI D. There seems to be a certain minimum time a CDFI has to dedicate to general office tasks (a minimum of 5%), staff meetings (around 5%), queries (4-6%) and report preparation (3-5%).

CDFIs also seem to have to invest considerable time on promotional activities. Promotional activities include attending external meetings and presentations, outreach activities, marketing, liaising with partners and networking. With the exception of CDFI A, the CDFIs spend between 10 and 17% of their time on promotional activities.

CDFI D spends the greatest proportion of its time on promotional activities compared with the other CDFIs. This is largely because the organisation has a dedicated outreach worker. Nearly 70% of education, outreach and marketing activities and 22% of external meetings and presentations are accounted by the outreach worker. A further 20% of external meetings are attended by the organisations home improvement loans officer.

Because the CDFIs in the sample are still dependent on granted loan capital and other forms of subsidies, they must invest considerable time on maintaining contracts and relations with public and private sector organisations. This may explain the considerable time invested in external relationship management and promotional activities.

Further, the particular properties of more complex financial products, such as the home improvement, make them demanding in terms of external management. The CDFI specialising in the provision of this financial product, CDFI E, spends more than 14% of its productive time on promotional activities – second only to CDFI D, whose emphasis on promotional activities is largely explained by its outreach worker.

Essentially, the home-improvement loan is a service to local authorities to help them reach the government targets for the proportion of the housing stock complying with the decent homes standards. Therefore, the CDFI in question needs to invest considerable time in providing technical information to interested local authorities and in negotiating terms for the delivery of home improvement loans. Once in operation, there is frequent contact between the CDFI and the local councils. The latter refer all clients after an assessment of eligibility and of cost of bringing the house in question up to decent home standard.

Tasks involved in making a loan constitute the second most time-consuming category, hovering between 20 and 40% of productive time. CDFI C, which spent the least amount of time on making loans, reported unusually low number of applicants and an above-average number of no-shows in the course of the timesheet exercise period. Once the loan has been made, relatively little time is dedicated to servicing loans – between 2 and 5%. This reflects the insistence among CDFIs that successful applicants open up current accounts and set up direct debits to repay the loan.

However, once a client falls in arrears with their payments, the CDFIs display great willingness to invest considerable time and effort in chasing arrears. The personal lending CDFIs spend between 8 and 13% of their time on delinquency control. In the case of CDFI E, the low arrears control resulting from extremely low default rates is most likely a result of the very thorough screening process and the close relationship between the loans officers and the borrowers, which in turn is a function of the particular characteristics of the home improvement loans.

In the follow-up interviews, the loans officers tended to stress the importance of "getting on top" of clients falling behind on their payments. In the case of CDFI C, the administrator would also strive to give known bad payers a call before the payment was leaving their account to ensure that there was sufficient funds to cover the payments.

The rationale behind early intervention appeared to be two-fold. On the one hand, there seemed to be a genuine concern for the social consequences for the household of falling into arrears. On the other, there was a concern that unless early action was taken the loan would never be recovered and that inaction on behalf of the CDFI would foment a non-payment culture among other borrowers through sending a message that "we don't care about repayment of loans, so why should they."

Although all personal lending CDFIs emphasise the importance of keeping arrears at manageable levels, CDFI A kept the proportion of productive time dedicated to delinquency control at a lower level than the other CDFIs. The relatively low proportion of productive time spent on delinquency control seems to be related to the

CDFI's arrears management system by which arrears reporting is contracted to a third party. Under this system, the staff members only need to action upon clients that fail to meet their payments and not on monitoring arrears.

In terms of dealing with loan enquiries, CDFI A and CDFI C spend more than twice as much time on such enquiries compared to CDFI B and CDFI D. For CDFI A this is probably because of the great volume of loan enquiries the CDFI has and the local reputation it has developed.

In the case of CDFI C, there seems to be three drivers. First, the organisation does not have a proper shop-front, so when customers make enquiries at its premises, the administrator has to leave the office to deal with the enquiry. Second, the business lending staff deals with 35% of loan enquiries and in many cases business loan enquiries involve a preliminary discussion of cash flow and business plans. Third, personal loan enquiries involve a pre-interview screening of applicants.

Table 5: Most time-consuming tasks for all staff (% of total productive time)

CDFI A	CDFI B	CDFI C	CDFI D	CDFI E
Total interview time (14.6)	Office general (11.2)	Arrears control (11.5)	Arrears control (9.6)	Office general (15.0)
Office general (12.2)	Total interview time (11.0)	Loan enquiries (8.0)	External meetings (7.6)	Travel time (13.5)
Loan enquiries (7.1)	Issuing of loan/ loan adm (9.3)	Office general (8.0)	Issuing of loan / loan adm (7.3)	External meetings (11.2)
Arrears control (6.9)	Arrears control (7.9)	Total interview time (6.5)	Total interview time (6.5)	Issuing of loan/loan adm (11.2)
General queries (6.8)	General queries (6.2)	External meetings (5.9)	Report writing (5.7)	Staff meetings (5.9)

Notes: Percentage of productive time spent on task is shown in brackets
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Table 5 displays the five most time-consuming tasks for each of the CDFIs. It is important that this is not confused with the activities in Table 4. For example, arrears control and debt collection combined form the activity of delinquency control.

The first observation we can make is that there are many similarities across the different personal lending CDFIs. All these CDFIs have total interview time and arrears control among their most time-consuming tasks. Moreover, CDFI C, CDFI B and CDFI A all have "office general" among their top-five list.

CDFI E, the specialised home improvement loan provider, is the only CDFI not to list total interview time among its most time-consuming tasks. The CDFI spends 5.5% of its total productive time on interviews, which is the lowest in the sample. However, it is important to take into consideration that its loans officers need to travel to interview their applicants, as opposed to the conventional branch service offered by the other CDFIs. So in fact, CDFI E dedicates nearly 20% of its time on either interviewing clients or travelling to conduct an interview.

3.3 The use of time by administrators

This section analyses the use of time among the administrators across the participating CDFIs (Table 6).

Table 6: Proportion of time spent by admin staff by category (% of productive time)

	CDFI A	CDFI B	CDFI C	CDFI D	Average score	CDFI E
Loan enquiries	4.9	4.5	11.5	14.9	**9.0**	0.0
Money advice	0.0	1.6	3.4	0.0	**1.3**	0.0
No shows	0.0	0.0	0.0	0.0	**0.0**	0.0
Making loans	19.8	2.9	21.4	9.9	**13.5**	2.8
Month-end reports	1.5	3.2	3.7	3.3	**2.9**	9.5
Servicing loans	13.7	15.5	16.0	23.2	**17.1**	6.7
Delinquency control	10.7	0.0	15.7	11.9	**9.6**	0.0
Promotional activities	0.0	0.0	8.9	0.3	**2.3**	0.0
Office management	40.3	69.9	19.4	36.5	**41.5**	71.0
Other activities	9.1	2.4	0.0	0.0	**2.9**	10.0

Notes: Reported as percentages based on weighted data
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Here there is considerably more variation than could be observed for the CDFIs as a whole. This variance centres principally on the extent to which the administrators get involved in loan provision, dealing with loan enquiries and giving applicants money advice.

On the one hand there are CDFIs whose administrative staff specialise almost purely on office management tasks, with very limited involvement in the CDFI’s core activities. This is very much the case of CDFI B, where the administrator spends little time on lending activities (with the exception of servicing loans).

The administrator at CDFI B spends approximately 20% of her time on PA work for the managing director, arranging meetings and producing special reports. Moreover, in the course of the timesheet exercise, the CDFI B administrator spent considerable time on negotiations in relation to setting up a new branch office, including discussing the lease and terms of the move. In addition, the administrator also gets involved in IT support.

On the other, the administrators at some CDFIs have an extensive involvement in the making, servicing and monitoring of loans, which is the case at CDFI A. The rationale behind this division of labour seems to be to maximise the exposure of lending staff to clients. As we will see when looking at the timesheet data for the loans officers, the model seems to achieve that, as CDFI A lending staff spend more time than the loans officer of any other CDFI on dealing with potential customers.

The two above-mentioned divisions of labour seem only to work in the larger organisations. In the case of CDFI C, the smallest CDFI in the sample, the administrator has a non-specialised role getting involved in all aspects of the operation of the CDFI, including promotional activities, dealing with loan enquiries and making loans.

The variation may in some cases also be a result of the particular product. In the case of CDFI E, the home improvement loan provider in the sample, most tasks relating to making, servicing and monitoring of loans are devolved to the loans officers. The administrator focuses on providing a limited range of back-office services.

Table 7: Most time-consuming tasks for admin staff (% of total productive time)

CDFI A	CDFI B	CDFI C	CDFI D	CDFI E
Opening of loan a/c (16.9)	Office general (30.4)	Arrears control (15.7)	Loan enquiries (14.9)	Other “sustaining activities (35.7)
Office general (15.3)	Invoices (14.6)	Loan enquiries (11.5)	Arrears control (11.9)	Office general (28.2)
Queries (14.3)	Queries (12.3)	Issuing of loan paperw. (11.0)	Posting paym to loan a/c (10.7)	Other identifiable (10.0)
Arrears control (10.7)	Posting paym to loan a/c (12.0)	Office general (8.6)	Office general (10.1)	Month-end reports (9.5)
Direct debits (10.2)	DWP Returns (7.1)	Queries (7.3)	Direct debits (9.0)	Posting payments to loan a/c (6.7)

Notes: Percentage of productive time spent on task is shown in brackets
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Table 7 displays the five most time-consuming tasks for administrators and seems to reinforce the findings of the preceding section. In the case of CDFI A, where the administrators’ role is geared towards lending support to maximise the time loans officers spend on seeing potential clients. As the only CDFI in the sample, the administrators at CDFI A have “opening loan accounts” as one of their most time-consuming tasks. The CDFI also lists direct debts, arrears control and spends more than 9% of their time on opening savings accounts, listed under other activities, which is seen as a key service to its clients.

Conversely, the list of most time-consuming tasks for the CDFI B administrator, who focuses predominantly on general administrative support, contains only one task relating to the core activities: posting payments to loan accounts.

3.4 The use of time among managers

This section looks at the use of time among managers across the CDFIs (Table 8).

Table 8: Proportion of time spent by management by category (% of productive time)

	CDFI A	CDFI B	CDFI C	CDFI D	Average score	CDFI E
Loan enquiries	1.6	1.2	3.8	0.7	**1.8**	0.0
Money advice	0.0	0.0	0.0	0.0	**0.0**	0.0
No shows	0.0	0.0	0.0	0.0	**0.0**	0.0
Making loans	17.2	11.4	12.1	3.2	**11.0**	3.4
Month-end reports	12.4	4.0	7.7	6.1	**7.6**	1.3
Servicing loans	0.0	0.9	4.9	0.1	**1.5**	0.0
Delinquency control	7.4	1.7	7.6	0.9	**4.4**	0.3
Promotional activities	6.9	25.8	13.9	35.1	**20.4**	25.0
Office management	54.5	54.0	48.3	47.5	**51.1**	64.4
Other activities	0.0	1.0	1.7	6.4	**2.3**	5.6

Notes: Reported as percentages based on weighted data
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

One of the factors distinguishing the CDFIs is the degree of management involvement in making loans. On the one hand, the management of CDFI D and CDFI E only have very limited involvement in making loans. CDFI D estimates that one third of the loan book is derived from or linked to specific external funds and thus stresses that maintaining relations and contracts with funders is essential.

The management in CDFI D spend considerable time on DWP returns. These are conducted mainly by a manager who has 80% of her position funded by the Growth Fund. The management of CDFI D pointed out that the DWP returns were particularly complex in that they involved seven sub-contractors. Considerable time and effort goes into training these partners in collecting the necessary data and in ensuring that this data is collected.

On the other, there are managers who are much more involved in the loan process, particularly CDFI A and CDFI C. In the case of the former, the managers spend more than 6% of their time on interviews alone, which is more than the managers in all the other CDFIs combined. This is largely a reflection of the organisational culture of CDFI A. All the organisation’s activities are centred on increasing the loan book through seeing potential clients. To be able to do that, managers cover for loans officers on leave and generally offer extensive lending support.

Table 9: Most time-consuming tasks for management (% of total productive time)

CDFI A	CDFI B	CDFI C	CDFI D	CDFI E
Report prep (13.7)	Report prep (14.2)	Planning (8.2)	Ext meetings (18.1)	Office general (16.8)
Office general (12.7)	Education etc (12.2)	Office general (8.0)	DWP Returns (16.4)	Ext meetings (16.4)
Month-end reports (12.4)	Planning (11.6)	Staff meetings / training (6.5)	Liaise with partners (15.8)	Staff managem. (14.3)
DWP returns (8.3)	Ext meetings (8.0)	Education etc (6.3)	Planning (12.2)	Planning (11.9)
Staff meetings (8.0)	Board /committee (7.5)	Review application& DWP returns (4.6)	Report preparation (7.4)	Staff meetings / training (9.4)

Notes: Percentage of productive time spent on task is shown in brackets
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Interestingly, DWP returns are among the most time-consuming tasks for three out of the four personal lending CDFIs. CDFI B, the only CDFI not to have it in its top-five list of time-consuming tasks, commented that they spent considerable time on the DWP quarterly returns, but that they did not complete these in the period in question.

3.5 The use of time among loan officers

This section analyses the use of time among the loan officers across the participating CDFIs (Table 10). The loans officers play a crucial role in a CDFI. They have the most extensive contact with the client base and often build relations with customers, vital in informing lending decisions and in limiting defaults and loan losses. Ultimately, the prospect of a fully operationally sustainable CDFI sector hinges, at least in part, on lending staffs ability to see potential clients and make loans.

Table 10: Proportion of time spent by lending staff by category (% of productive time)

	CDFI A	CDFI B	CDFI C	CDFI D	Average score	CDFI E
Loan enquiries	11.8	2.6	13.4	1.7	**7.4**	0.6
Money advice	4.0	0.1	0.8	0.1	**1.3**	0.7
No shows	5.6	0.1	0.1	1.7	**1.9**	0.1
Making loans	46.5	54.4	38.5	48.9	**47.1**	58.4
Month-end reports	0.0	0.0	0.0	0.0	**0.0**	0.0
Servicing loans	0.0	0.0	0.0	0.0	**0.0**	0.0
Delinquency control	7.2	17.4	21.6	18.9	**16.3**	3.9
Promotional activities	2.8	2.9	8.7	6.9	**5.3**	12.5
Office management	21.8	18.8	16.9	19.7	**19.3**	21.5
Other activities	0.3	3.7	0.0	2.1	**1.5**	2.2

Notes: Reported as percentages based on weighted data
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

Before turning to the analysis, it is important to highlight a disclaimer concerning the degree of accuracy of the data from CDFI A. Two of its loans officers – equivalent to 1.5 full-time positions, did not participate in the timesheet exercise. Both of the non-participating loans officers worked in the head office dealing with the greatest volumes of loans. Furthermore, there were cases of consistent over-reporting of the number of minutes in the allocated two-hour slots.

Making loans constitutes the single most time-consuming activity for loans officers. In terms of making loans, CDFI E spends the greatest proportion of their time on making loans in the sample and the remaining time on sustaining activities. A small proportion of their time is also spent on monitoring arrears.

Issuing a home improvement loan is an onerous process, involving three loan interviews totalling over two hours at the applicants home, extensive travelling and considerable paper work. In some cases, if the local council does a very thorough job in preparing the applicant and if the case is uncomplicated, then the second and third interview may be combined.

In addition, because all applicants go through the district council, the process involves extensive liaising with local government representatives concerning specific cases and reporting on progress. On top of that, the loans officer job involves considerable liaison with and provision of technical advice to potential customers in the form of local councils.

CDFI B loans officers also stand out in that they spend considerable more time on making loans relative to the other CDFIs, save CDFI E. However, as we discuss in more detail below, this is in part because the lending personnel spends more time on loan administration compared to the other CDFIs, again with the exception of CDFI E.

Three out of the four personal lending CDFIs spend around 20% on delinquency control. This activity generally involves monitoring daily, weekly or monthly bank reports of direct debits, and acting accordingly by calling, paying visits to or sending letters to the clients. The lending staff are to varying degrees supported by administrators and managers in monitoring and acting upon non-payment.

Home visits, phone calls and, to a lesser extent, letters to the clients make arrears collection an onerous task for many CDFIs. In particular home-visits are time-consuming with uncertain returns as many bad payers will not answer their door knowing that the CDFI might come knocking. For security reasons, home visits also tend to involve sending two staff members.

Lending staff at CDFI A spend considerably less time on delinquency control than the other CDFIs. The reason for this appears to be its arrears monitoring system. Essentially, CDFI A contracts out its arrears reporting to a third party, which produces daily arrears reports for CDFI A. This system notifies the loans officers which of their clients have fallen behind on their payments and they follow this up by calling the client in question. All other aspects of the delinquency control, arrears monitoring, sending out letters, debt collection and further follow-ups, are dealt with by administrative and management staff.

The data certainly seem to suggest that the system saves CDFI A time, as it spends the smallest proportion of time on delinquency control. As the system was only introduced in October 2006, the long-term implications of outsourcing arrears reporting on bad debt are yet to be known. However, the financial data does not suggest that CDFI A have higher arrears rates.

This time-saving arrears reporting system combined with the way in which support and management staff are organised enables lending staff at CDFI A to spend more time than the other CDFIs on seeing potential clients. This in turn seems to drive up the productivity of personal loan officers, as discussed below.

Table 11 displays the most time-consuming tasks by CDFI and reveals some interesting results.

Table 11: Most time-consuming tasks for lending staff (% of total productive time)

CDFI A	CDFI B	CDFI C	CDFI D	CDFI E
Total interview time (26.2)	Total interview time (21.1)	Arrears control (21.1)	Arrears control (13.5)	Travel time (interview) (20.8)
Loan enquiries (11.8)	Issuing of loan / loan admin (18.1)	Total interview time (16.8)	Issuing of loan / loan admin (13.2)	Issuing of loan / loan admin (17.3)
Interview prep (11.1)	Arrears control (14.4)	Loan enquiries (13.5)	Total interview time (11.6)	Office general (12.4)
Office general (10.8)	Office general (9.1)	Issuing of loan / loan admin (11.4)	Report writing (10.2)	Ext meetings/ presentations (11.0)
General queries (7.2)	Report writing (8.6)	Ext meetings /presentations (8.5)	Travel time (interviews) (6.4)	Total interview time (8.5)

Notes: Percentage of productive time spent on task is shown in brackets
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

The first observation is that there are several similarities in the way in which the loans officers across the different CDFIs spend their time, particularly in the case of the CDFIs concentrating on personal lending. The total time spent interviewing clients is among the most time-consuming tasks for loans officers of allf the CDFIs. With the exception of CDFI A, arrears control is among the most time-consuming tasks of the personal lending CDFIs. Issuing and administering a loan is also listed by all CDFIs, except for CDFI A. The reason this task is not listed by CDFI A lending staff may be the extensive loan support offered by the administrators.

Indeed if the time spent on interviews, attending to loan enquiries and on giving general money advice is totalled, lending staff at CDFI A seems to have more direct customer contact than any other CDFI. Based on these figures, loans officers at CDFI A spend around 45% of their time dealing directly with clients compared to approximately 30% (CDFI C), 25% (CDFI B), 15% (CDFI D) and less than 10% (CDFI E) for the other CDFIs. The CDFI A model seems to centre on maximising the loans officers’ exposure to clients by assigning most other tasks not directly linked to the loan interviews to the administrators and, to a lesser degree, to the management.

CDFI B, which spends the most time on making loans of the personal lending CDFIs, spends a great deal of that time on loan administration and report writing as opposed to dealing directly with the customer. For a loans officer at CDFI B administrating a loan involves, among other tasks, taking the successful applicant’s bank details and creating a standing order.

3.5.1 Loan officer productivity

So far we have looked at how much time loans officers spend on different tasks, such as making loans and chasing arrears. However, ultimately the productivity and efficiency of a loans officer is to a large extent determined by how they spend that time. Therefore, this section looks at how many applicants each loans officer saw and how much time was spent on each applicant on average in the course of the timesheet exercise (Table 12).

Table 12: Loan officer productivity

	CDFI A	CDFI B	CDFI C	CDFI D	Average score	CDFI E
# applicants seen weekly per FT loan officer	16.7	10.2	6.9	6.1	**10.0**	2.2
Average interview preparation per applicant*	15.0	5.5	12.8	7.0	**10.1**	30.0
Average interview time per applicant*	35.4	47.2	43.2	42.1	**42.0**	84.8
# of FT loan officer positions	3.5	3.0	1.95	5.45	**3.5**	3.0

Notes: * = data is given in number of minutes
FT = Full-time
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

This analysis is complicated by the fact that the CDFIs offer a range of financial products – home improvement loans, business loans, social enterprise loans and personal loans – which all differ in applicant numbers and time spent on interviews. This may have particular effect on CDFI D who offer home improvement and business loans, CDFI B who offers social enterprise and business loans and CDFI C, who have a considerable business loans portfolio. CDFI A and CDFI E, conversely, are the most specialised CDFIs, focusing on the provision of personal and home improvement loans respectively.

Therefore, to take this differentiation into consideration, this section also draws on data from the interviews with the loans officers and, to a lesser extent, with the administrators and managers. In addition, the section relies on data provided by the CDFIs on completions, appointments and no-shows for the period.

On average, considerable time seems to go into interviewing loan applicants. According to lending staff, business and home improvement loans interviews are the most time-consuming, taking between 45 and 90 minutes per interview. In the case of home improvement loans, three interviews are conducted per applicant. The first interview lasts around an hour, while the second and the third interviews last about 30 and 45 minutes respectively.

Personal loans interviews seem to oscillate between 30 and 45 minutes. According to lending staff, interviews with repeat clients take about 10 minutes less. CDFI D is currently considering introducing postal and telephone applications from repeat clients to reduce or end interviews with repeat clients.

Two factors seem explain the relative time-intensive nature of loan interviews. First, virtually all loan officers reported that considerable time is often lost because the applicant has not filled in the application form properly. So the loans officer has to complete the form for the applicant. Second, and not unrelated to the first point, the loans officer will invariably spend part of the interview on educating the interviewee in financial matters. At a minimum, this financial education seems to involve spending 5-10 minutes explaining to the client the costs and implications of taking out a loan. In the case of CDFI B, the loans officer will educate the applicant on household budgeting

Yet other CDFIs will offer services that are strictly non-essential for the loan granting process. CDFI A considers opening savings accounts a core part of their service to the customer, despite the fact that it is not necessary to provide a loan. Loans officers may spend as much as 20 minutes of the interview on opening up savings account. In the main branch, this job will be done by the administrators who are spending nearly 10% of their productive time on this task.

The number of loan applicants interviewed per week varies between 2 and 17. However, with the exception of CDFI B, the number of applicants interviewed was generally seen as inaccurate by lending staff. In CDFI C, 10-15 applicant interviews per full-time loans officer per week was seen as more accurate. According to CDFI D personal lending staff 18 applicants per week was more representative, while at CDFI A a loans officer could see as many as 30 per week. For CDFI E, the number of applicants varies between 5 and 10 weekly.

3.5.2 Personal loan officer productivity

Notwithstanding possible inaccuracies, it is possible to make some estimates about how many loans a personal loans officer can make in the course of a year. The focus here is on personal loans officers, because this is the mainstay of the CDFIs in the sample, with the exception of CDFI E. Furthermore, because of the small size of personal loans, it is crucial to be able to process as many loans as possible per loan officer to increase revenue. Finally, the larger number of personal loan officers than for business and home improvement loan officers enabled us to make more confident estimates on their productivity.

Table 13 displays the number of applicants and the number of loans processed per full-time personal loans officer position[3] per year. The number of applicants is estimated based on how many applicants the loans officers interviewed in the course of the timesheet exercise. The number of successful personal loan applicants per officer is calculated based on the assumption that 60% of all loan applicants are successful. In turn, we based this figure on the percentage of successful applications for CDFI B for the period of April to July, 2007, which is 64%.

Table 13: Personal loans officer productivity

	CDFI A	CDFI B	CDFI C	CDFI D	Average score
Annual # of applicants seen per FT loan officer	733	513	342	422	**533**
Annual # of loans process per FT loan officer	440	308	205	253	**320**

Notes: Estimated based on unweigthed data
Source: Timesheets submitted by CDFI employees for the period 25.06.07-13.07.07

[3] It is assumed that a full-time personal loans officer works 44 calendar weeks annually.

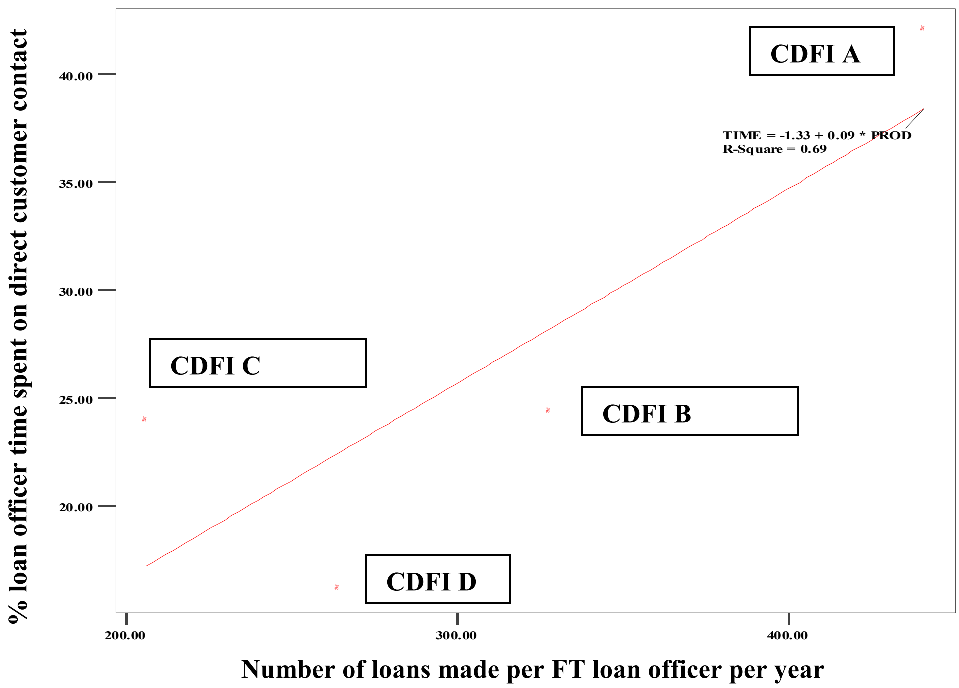
The resulting data reveals some striking differences in the personal loans officer productivity. One CDFI outperforms the other CDFIs by a considerable margin. CDFI A personal loans officers interview more than twice as many loan applicants as CDFI C, 220 more compared with CDFI B and 311 more applicants than CDFI D.

There seems to be three factors explaining the varying loan officer productivity of the CDFIs. First, the number of applicants a loans officer can interview is conditional on the availability of appropriate meetings rooms. In the case of CDFI B, two loans officers and two debt advisors share one meeting room, limiting the number of loan applicants a loans officer can see in the course of a working day. Similarly in the case of CDFI C, two personal loans officers and one business loan officer compete for one interview and meeting room. In addition, the lack of a proper shop front may deter potential customers.

Second, the data also suggest that a high proportion of repeat business is conducive for loan officer productivity. Repeat loans are often considerably less demanding in loan administration and staff time. A repeat client is likely to already have a bank account, and a top-up loan may often only require a telephone call and the client coming in to sign a credit agreement. Repeat clients are also less likely to default on their payments. CDFI A which displayed the greatest loan officer productivity also had the greatest proportion of repeat clients: 56% of loans issued in the financial year of 2006/2007 were to repeat customers, compared to 7% (CDFI B), 33% (CDFI D) and 52% (CDFI C).

Finally, the timesheet data suggest that there is a link between the proportion of productive time spent on seeing clients and loan officer productivity as depicted in Figure 2.

Figure 2: Direct customer contact and loan officer productivity



CDFI A which puts the greatest emphasis on maximising the time loans officers spend on interviewing, by involving administrators and managers in offering lending support, also processes the greatest number of loans per full-time loan officer position. Further, our findings suggest that part of maximising lending staff exposure to potential customers may also lie in outsourcing administrative aspects of arrears control and possibly other areas to external companies. In other CDFIs there seems to be a greater emphasis on allocating time for loans officers to complete administrative tasks, as well as allowing them to work from home.

4 THE EFFECTIVENESS OF PARTNERSHIPS

4.1 Introduction

This chapter analyses the effectiveness of the partnerships which the CDFIs in the sample have formed. Partner organisations can increase the client base of a CDFI through referrals and marketing. In addition, the willingness of a partner organisation to donate loan capital and buy other service from a CDFI is determined by how effective they perceive the partnership and how reliable they perceive the CDFI to be.

In order to measure the effectiveness of these partnerships, the partner organisations filled in an online questionnaire. In total 27 partner organisations of four of the CDFIs have completed this (Table 14).

Table 14: Partner organisations by CDFI

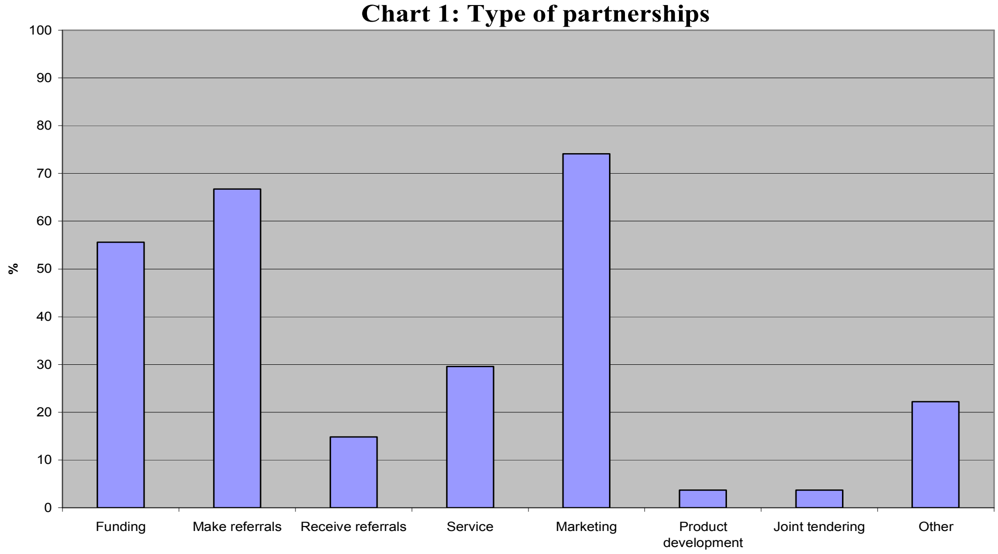
	CDFI A	CDFI B	CDFI C	CDFI D	CDFI E	Total
Housing association	1	3	..	3	0	**7**
Debt advice agency	0	0	..	2	0	**2**
Bank, build society	1	2	..	1	0	**4**
Local government	0	0	..	3	6	**9**
RDAs	0	1	..	0	0	**1**
Charity	0	0	..	1	0	**1**
Business advice	0	1	..	0	0	**1**
Other	0	2	..	0	0	**2**
Total	**2**	**9**	**..**	**10**	**6**	**27**

Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

Local government and housing associations constitute the majority of CDFI partners. In this sample, the majority of local councils are cooperating with the CDFIs in relation to the provision of home improvement loans. For housing associations, partnerships with the CDFI sector is seen as a key strategy in reducing the risk of households falling behind on their rent by offering an alternative to their tenants to pawnbrokers and doorstep lender who often charge very high interest rates.

Chart 1 (N = 27) displays what the CDFIs and their partners cooperate on.

Chart 1: Type of partnerships



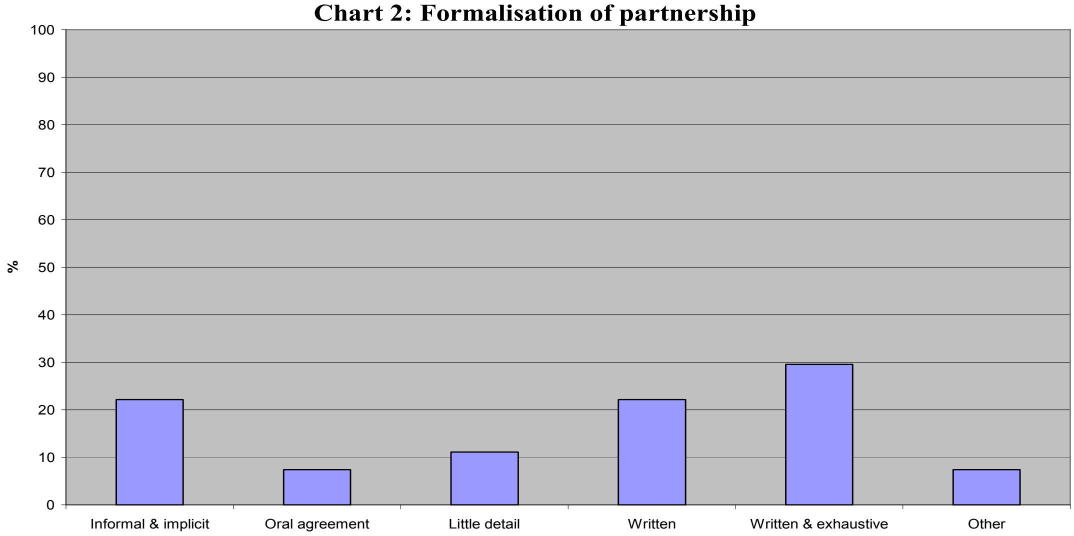
Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

The majority of partner organisations refer clients to the CDFI, market the CDFI's product to its clients and provide the CDFI with funding. About a third of the partner organisations fund the CDFIs in exchange for a service, which in all cases refers to home improvement loans.

Broadly speaking we can draw a simple typology of the different types of partnerships. First, there are the partnerships which CDFIs form with arms-length funders. Second, there are the organisations which fund a CDFI in exchange for a service, typically local governments funding CDFIs for the delivery of home improvement loans. Finally, there are the relationships between CDFIs and so-called peer organisations, which provide non-financial services to low-income households, such as debt and money advice. These organisations include job centres, debt advisory agencies, business links and housing associations. These relationships are typically limited to referrals and basic marketing.

Chart 2 (N = 27) displays the extent to which the partnership is formalised.

Chart 2: Formalisation of partnership



Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

Most partnerships seem to involve a written agreement covering most or all aspects of the partnership. This is particularly the case for home improvement loans. Six of the seven partnerships covered by an extensive written agreement are on home improvement loans. There is not discernible pattern as to the degree of formalisation of other forms of partnerships.

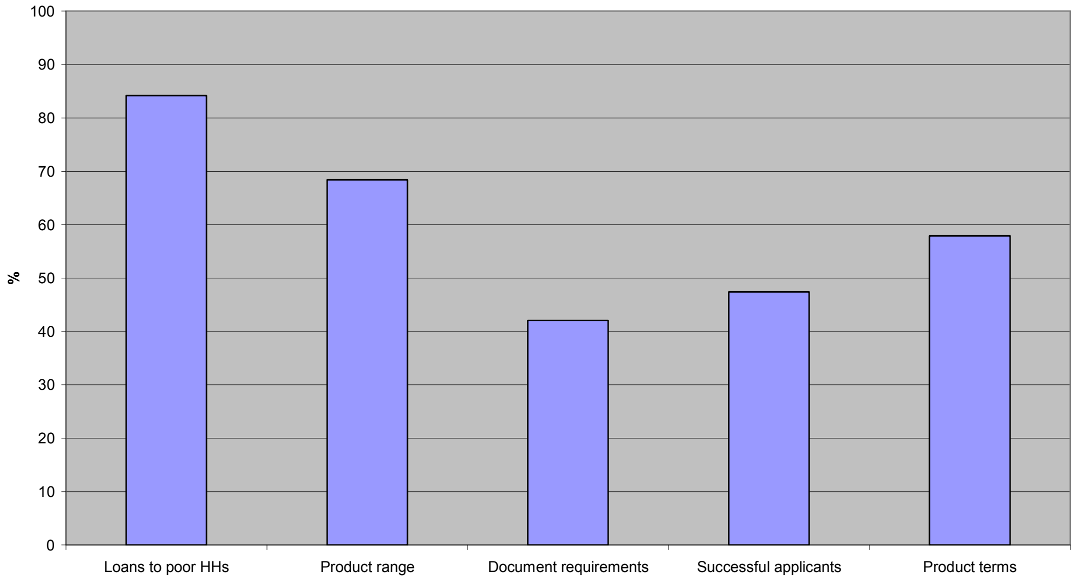
4.2 Referrals

Referrals are an important part of the partnerships. In the case of home improvement loans all clients are referred to the CDFI by a local authority. Nearly 70% of the partnerships of personal and business lending CDFIs are on referrals. Referrals are an important source of potential customers, particularly for business lending. As noted earlier the lack of referrals had a severe impact on the growth of Street UK (New Economics Foundation, 2004).

In total, 18 out of the 27 partnerships are referral-based. Eight out of these make less than one referral to the CDFI per week and seven make one referral per week, while only three partner organisations make more than one. The highest number of referrals is 10 and the average is 1.5. 15 of the referring partner organisations are local government, housing associations and money advice agencies. Most of the referrals from local government are made in relation to home improvement loans. For housing associations, referring tenants to a CDFI is an important part of their strategy to prevent households from falling into arrears on their rent, as a consequence of taking out unaffordable loans with doorstep lenders.

The effectiveness of referrals depends on the appropriateness of the referrals. The ability of partner organisations to make sound judgements on the extent to which a case is suitable for the CDFI depends, at least in part, on how familiar the staff members are with the products and services offered by the CDFI. Chart 3 (N = 19) displays the level of knowledge the partner organisations have about the products and services offered by the CDFI in question.

Chart 3: Partner knowledge of CDFI



Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

In most cases, the partner organisations' staff members will be aware that the CDFI offers financial products to low-income households. Nearly 70% will also be familiar with the range of products offered by the CDFI and over half will know the terms of the products.

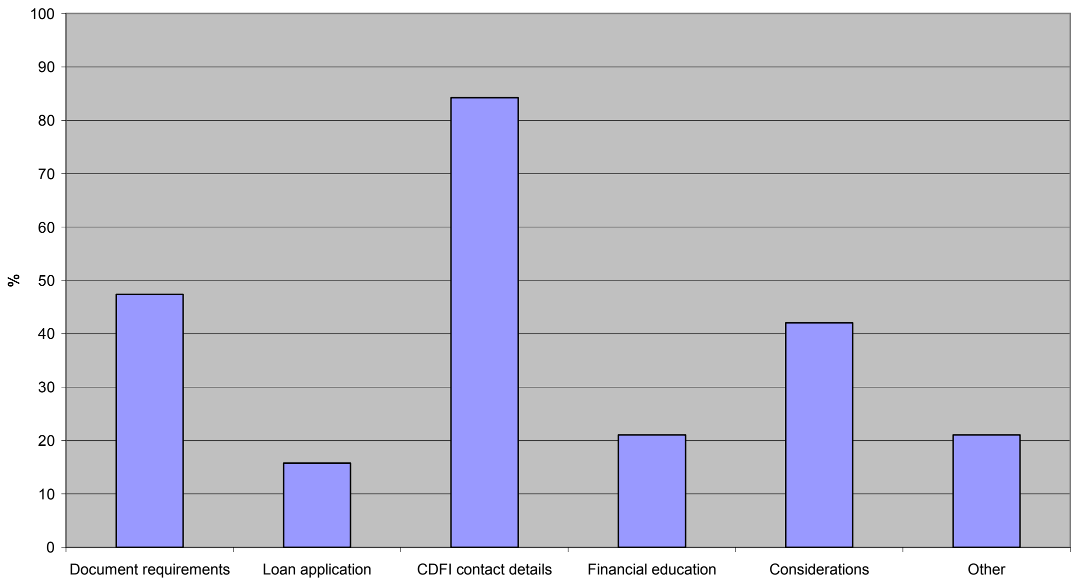
The relevant staff members for local government seem to be the most knowledgeable of the products, terms and implications. The majority of local government partners are familiar with the product range and terms, and document requirements. They also have an understanding of who would be likely to be successful in applying for a loan.

In most cases, these partnerships centre on home improvement loans. The CDFI invests considerable time in providing technical information to interested local authorities and in negotiating terms for the delivery of home improvement loans. Once in operation, there is frequent contact between the CDFI and the local council, as all clients are referred by the local council after an assessment of eligibility and an attainment of the cost of bringing the home in question up to decent home standard. Hence, it is not surprising that relevant local government employees have acquired a relative in-depth understanding of the product and the processes driving it.

For the other types of partnerships, the picture is more mixed, the partner organisation employees displaying a great deal of variation in their knowledge of the services of the CDFIs.

Not only are these partnerships a source of new clients, the partner organisations can also lead to decreases in the interview time and costs by prepping the loan applicants. Chart 4 (N = 19) shows what the different organisations tell their clients.

Chart 4: Partner preparation of referrals

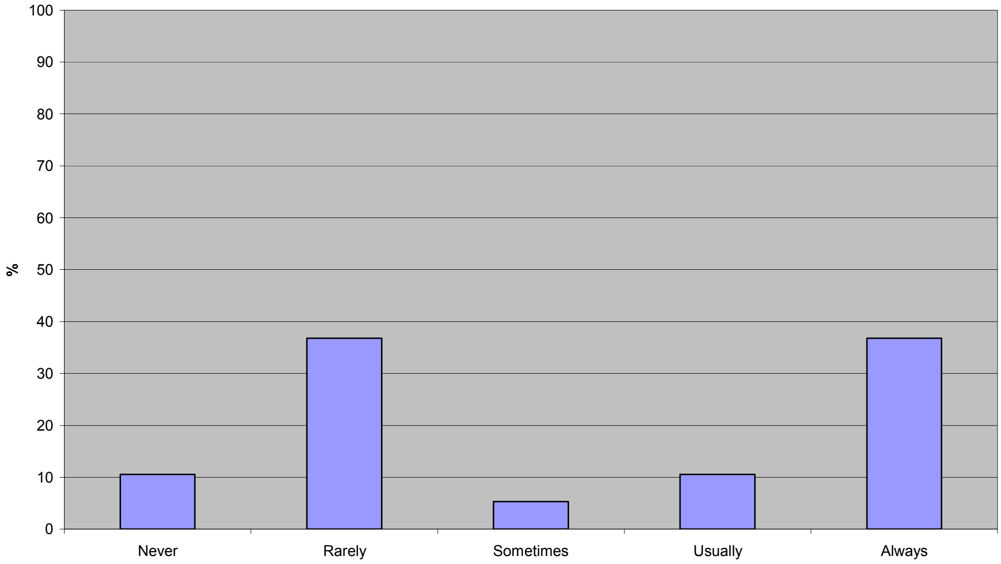


Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

Local governments will generally inform the clients about document requirements and help the clients fill in the loan application before referring them on to the CDFI. Money advice agencies and housing associations will give the referrals some basic education in household finance management prior to making a referral.

In addition to prepping the loan applicants, the partner organisation may further decrease the time and resources a CDFI invests in loan applicants, by briefing the loan officer and sign-posting potential problems. Chart 5 (N = 19) shows the extent to which the referring organisations contact the CDFI to inform it about the referral and the referral circumstances.

Chart 5: How often does partner contact CDFI concerning referral



Source: Online questionnaire filled in by CDFI partner organisations

Local governments providing CDFIs with funding in exchange for home improvement loans will in most cases get in touch with the CDFI concerning referrals. For all other organisations, it is more variable.

Referrals work both ways and in some cases it is the CDFI making referrals to selected partner organisations. Primarily, these types of referrals enable the CDFIs to enhance the social impact on low-income financially excluded households. The CDFIs in the sample decline around 40-50% of the applicants, many of which may be better served by debt advice or another form of service performed by other agencies.

Out of the organisations in the sample, only four receive referrals from the CDFIs. Two of these organisations receive less than one referral per week, while the two other organisations receive one and three referrals respectively

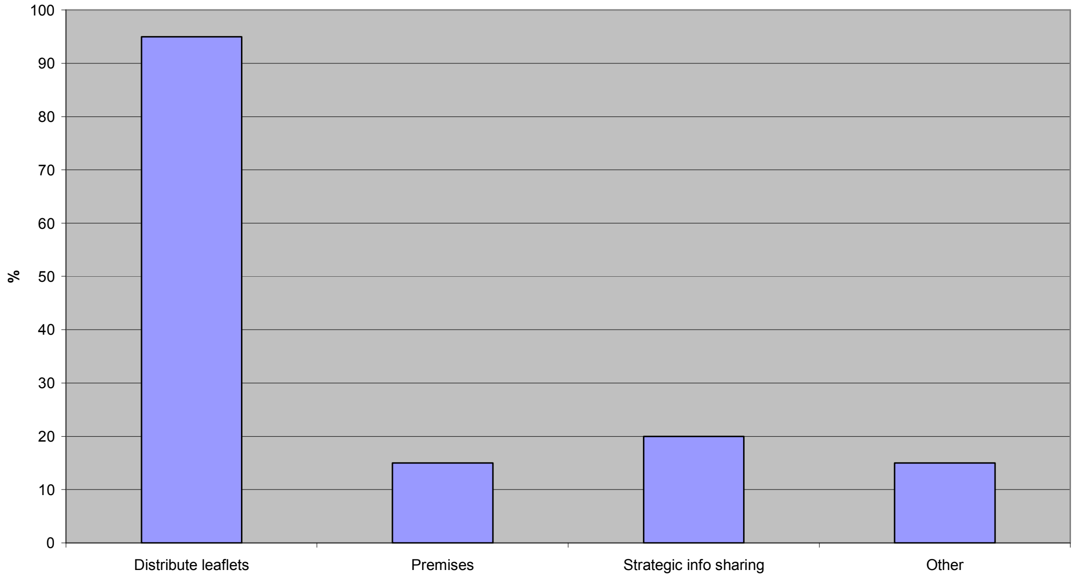
The extent to which the CDFIs can enhance their impact on low-income households depends on the appropriateness of the referrals they make. Two of the organisations consider the referrals made by the CDFI to always be appropriate and one usually, while one considers that the referrals are sometimes appropriate.

4.3 Marketing

Marketing their products to potential clients is a vital activity for CDFIs in order to reach out to a pool of customers. However, marketing campaigns, such as TV and newspaper adverts and canvassing target markets, can be very costly. Moreover, reaching a small audience, often distrustful of financial marketing, can be difficult.

Marketing partnerships may constitute a cost-effective way for reaching these markets for the CDFIs. Housing associations, job centres and other organisations may offer the CDFIs channels to large pools of potential clients. Over 70% (20 organisations) of the partner organisations conduct some form of marketing for the CDFIs. A marketing partnership may take numerous forms, from delivering leaflets through to sharing key information about the client group. Chart 6 (N = 20) displays the distribution by type of involvement.

Chart 6: Type of marketing conducted by partners



Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

The vast majority of CDFIs distribute leaflets and information about the CDFI to its clients. Only four partner organisations share strategic information about the target market with the CDFI.

4.4 Partner organisations' perceptions of the CDFIs

The way in which partner organisations perceive the CDFI and the services it provides is likely to be important for their willingness to invest time and resources in a partnership, enhancing its effectiveness. Thus, in the online questionnaire the partner organisations were asked to indicate the extent to which they agreed with seven statements relating to the effectiveness and reliability of the CDFI and their partnership with the CDFI.

Overall the survey data and comments made by the partners reveal a high degree of satisfaction with their partnership with the CDFIs (see Box 1 for some examples).

Box 1: Comments made by partner organisations

"CDFI D is a first class organisation which meets the needs of many of our customers" (Local government)

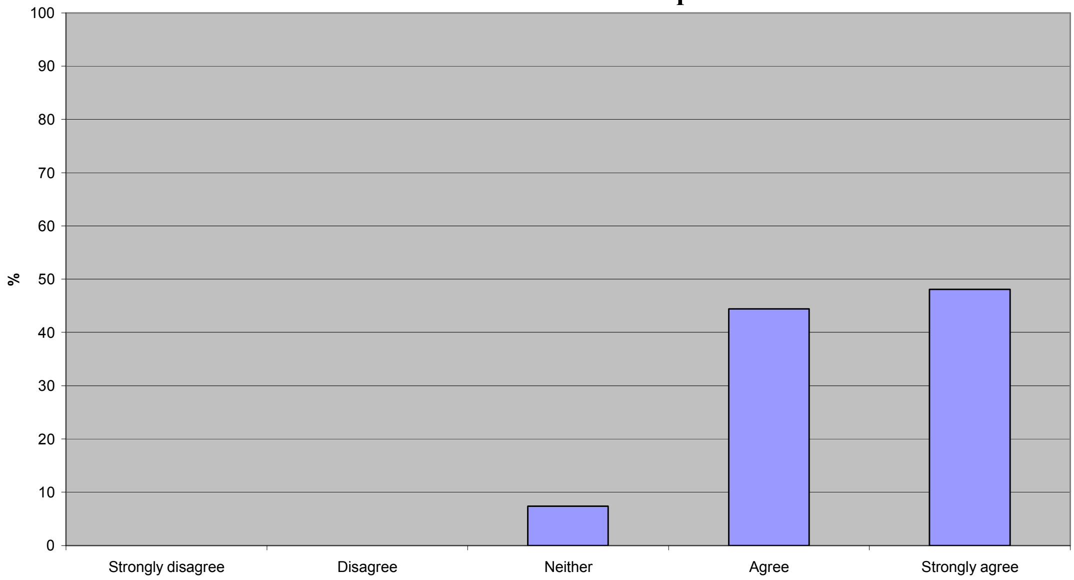
"CDFI D provides an excellent service to our members, that is relevant to their needs. However, the service does not offer good value for money in terms of the benefits gained by our residents relative to the cost to us as an organisation" (Housing Association)

"Excellent working relationship!" (Local government on CDFI E)

"Their communication with us in relation to the funding we have given them has been very good and they have also been very keen to support any ideas or requests we have made." (Bank on relationship with CDFI B)

Chart 7 (N = 27) shows the extent to which the respondents agreed that the CDFI in question was a reliable partner.

Chart 7: "The CDFI is a reliable partner"

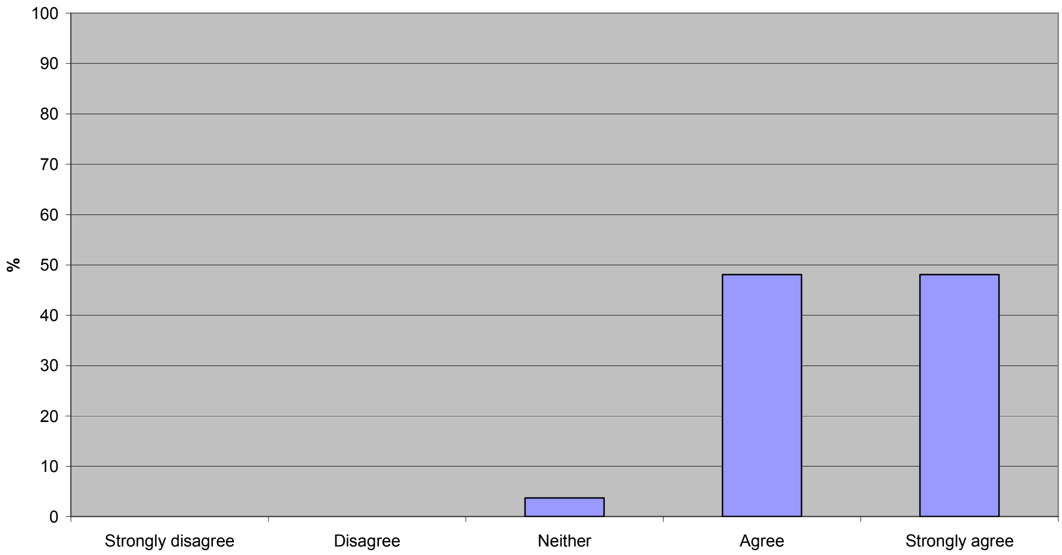


Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

Nearly half of the respondents strongly agreed that the CDFI in question was a reliable partner. A further 40% agreed with that statement. Local governments are the most positive with eight out of nine local authorities strongly agreeing with this statement. Housing associations come across as slightly less enthusiastic as they all agree or neither disagree nor agree.

Chart 8 (N = 27) shows the extent to which the respondents find the CDFI trustworthy.

Chart 8: "The CDFI is a trustworthy partner"

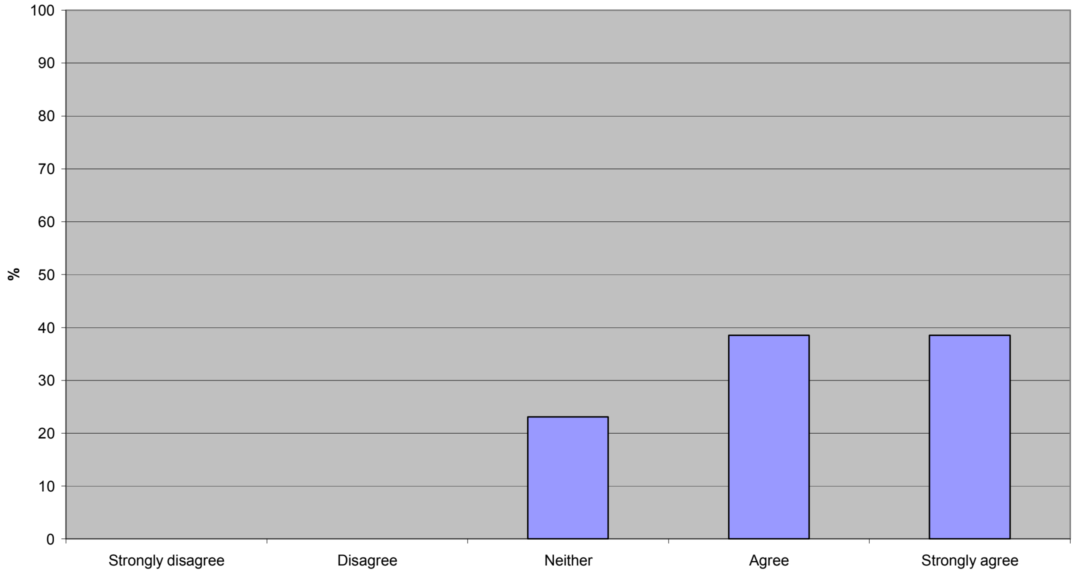


Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

The figure reveals a similar pattern to the preceding statement. Over 90% of partner organisations agree or strongly agree that the CDFI they cooperate with is trustworthy, with local authorities agreeing more strongly than housing associations.

Chart 9 (N = 27) shows the extent to which the respondents find that the CDFI listens to the partner organisation's concerns.

Chart 9: "The CDFI listens to our concerns"

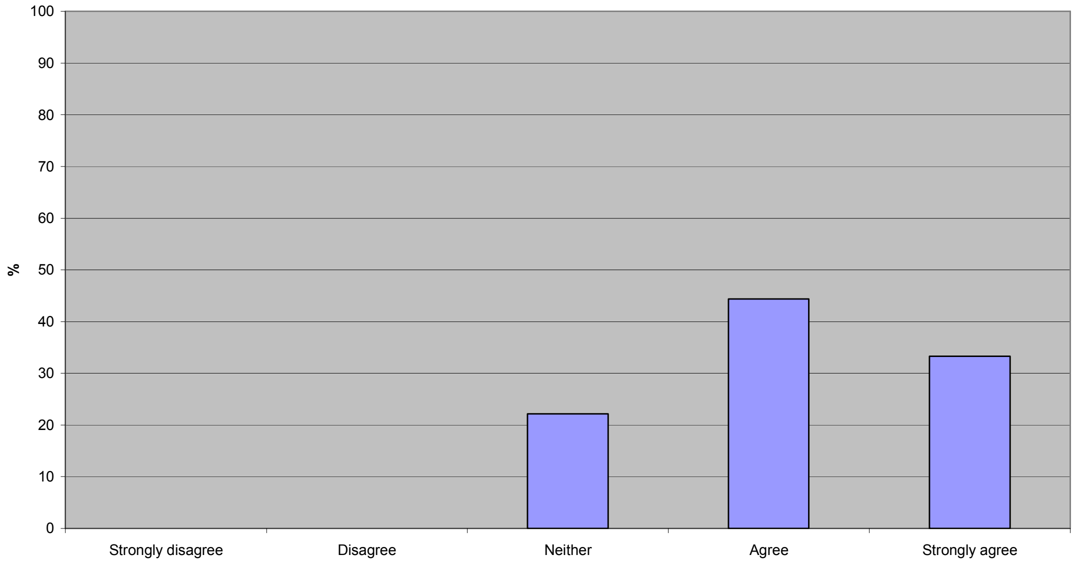


Source: Online questionnaire filled in by CDFI partner organisations

As with the two preceding statements, the majority of partner organisations agree or strongly agree with the statement that the CDFI listens to the partner organisation's concerns. However, the percentage is somewhat lower than in the previous two figures (80% compared to 90%).

Chart 10 (N = 27) shows the extent to which the respondents find that the CDFI accommodates their needs.

Chart 10: "The CDFI accommodates our needs"

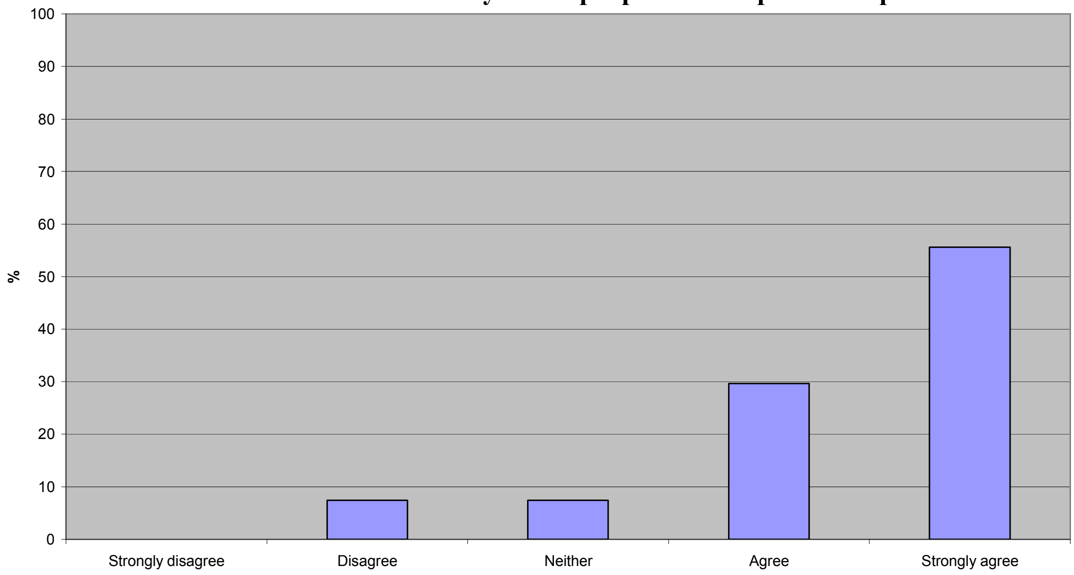


Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

Nearly 70% of the sample agrees (44%) or strongly agrees (22%) that the CDFI they are cooperating with is accommodating towards their needs.

Graph 11 (N = 27) shows the extent to which the respondents find that the purpose of the partnership is clearly stated.

Chart 11: "There is a clearly stated purpose of our partnership"

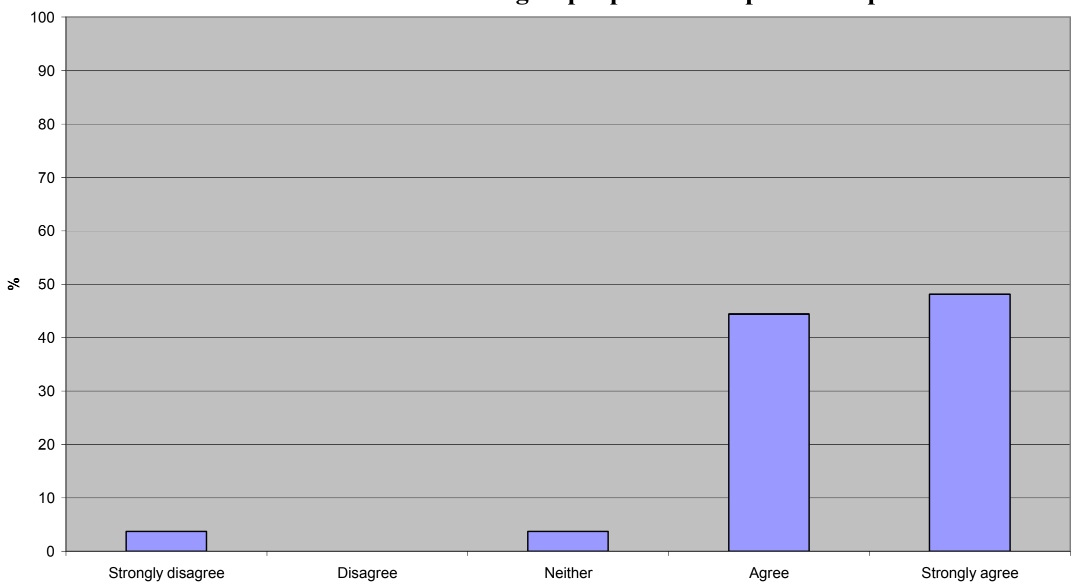


Source: Online questionnaire filled in by CDFI organisations September and October 2007

Nearly 90% of the sample agrees or strongly agrees that there is a clearly stated purpose of their partnership. In this case, the majority strongly agree (56%) rather than simply agree (30%). Notably, one partner organisation disagrees with this statement.

Chart 12 (N = 27) shows the extent to which the respondents find that the purpose of the partnership is meaningful.

Chart 12: "There is a meaningful purpose of our partnership"

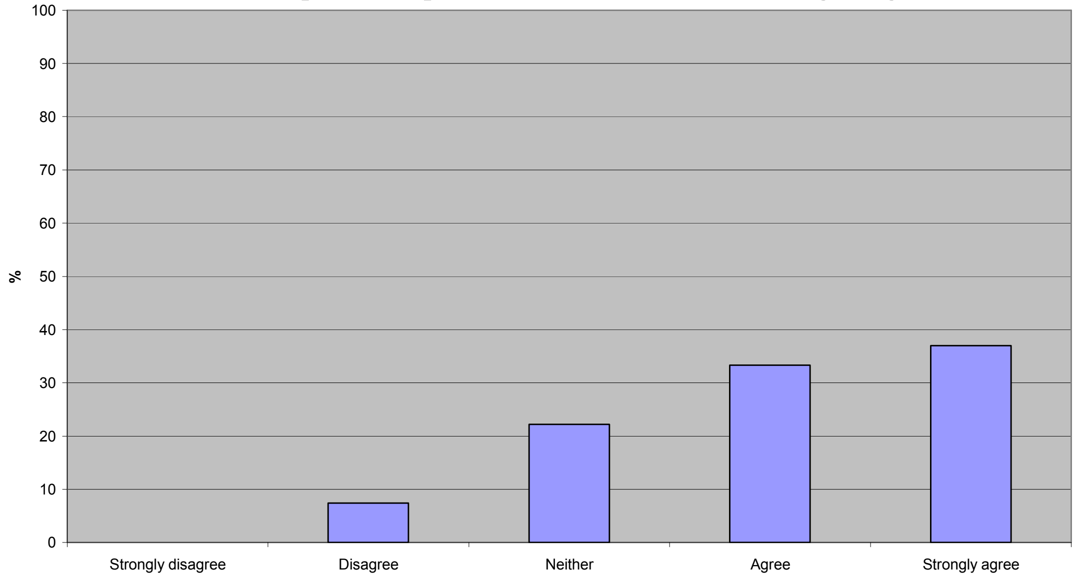


Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

In terms of the extent to which the respondents agree with whether the purpose of the partnership is meaningful, the trend is similar to the preceding statement, with over 90% agreeing or strongly agreeing with the statement. Again the majority strongly agree. However, one partner organisation strongly disagrees with this statement.

Chart 13 (N = 27) shows the extent to which the respondents find that the CDFI is an effective means of achieving their goals.

Chart 13: "Our partnership is an effective means of achieving our goals"



Source: Online questionnaire filled in by CDFI partner organisations September and October 2007

There seems to be less agreement on the extent to which the partnership with the CDFI is an effective means of achieving their goals. Two partner organisations disagreed that their partnership with the CDFI in question was an effective means of achieving their goals. A further six partner organisation neither agreed nor disagreed with this statement. Nevertheless, 70% either agree or strongly agree.

In summation, the majority of the partner organisations in the sample cooperate with the CDFIs on marketing, funding and on making referrals. Local authorities are most uniform in the extent to which their partnerships with the CDFIs are formalised, in their knowledge of loan products and processes and generally display the highest level of satisfaction.

5 LOAN PORTFOLIO ANALYSIS

5.1 Introduction

In this chapter we conduct an in-depth analysis of the loan portfolios of the CDFIs in our sample to assess and discuss their operational and financial sustainability. The chapter is organised into two sections. The first section analyses and discusses their current operational and financial performance. In the second section we extrapolate from current and historical data to project possible future development trajectories.

5.2 How sustainable are the CDFIs currently?

We now turn to degree to which these different business models are sustainable. In Chapter 2 we introduced two measures of sustainability. First, there is operational sustainability, which refers to the degree to which the CDFIs can cover their costs with income from their core activities (i.e. fee and interest rate income from its loan portfolio, and interest income from deposits). Second, financial sustainability refers to the degree to which the CDFIs are able to cover all their costs whilst raising all lending capital through recycling of existing funds and through commercial loans.

In a sense, the path towards a fully sustainable CDFI sector may be best viewed as a continual process where the starting point is total subsidy dependence and the arrival point is financial sustainability via operational sustainability. The CDFIs in the sample and in the UK more broadly are likely to be somewhere in between total subsidy dependence and operational sustainability. Therefore, in this chapter we mainly focus on the operational rather than financial sustainability.

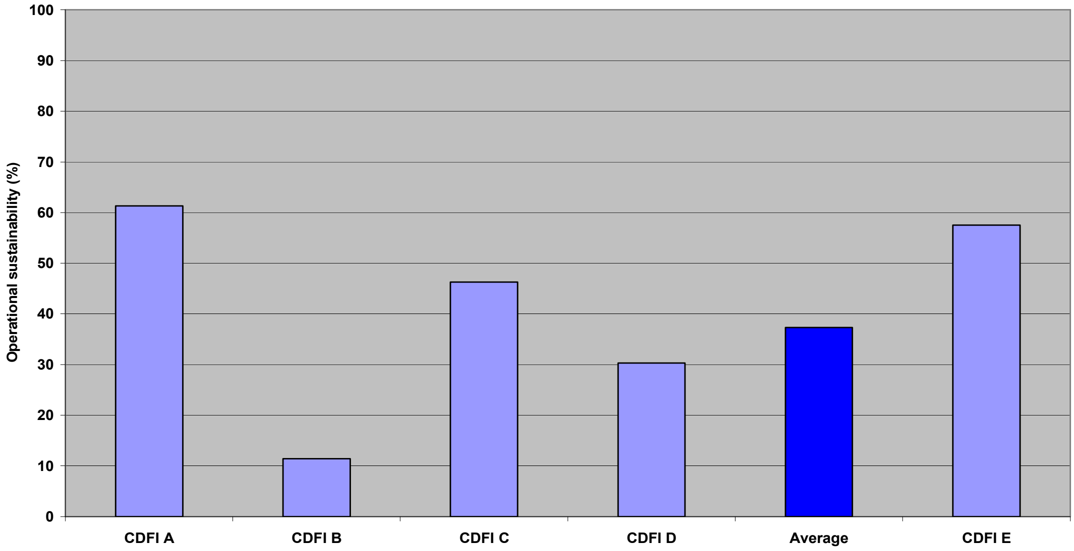
Chart 14 shows the degree to which the CDFIs are operationally sustainable. Specifically, using their most recent audited accounts, we calculate the total earnings (fees and interest income, and bank interest earned or paid) as a percentage of total overheads (staff, overhead and governance related costs). The average column refers to the average for the personal lending CDFIs (i.e. it excludes CDFI E).

We have not included contractual income in the form of fees paid for services (for example local authority subscription fees for home improvement loans), which is arguably different from pure grant income. A high reliance on contractual as opposed to customer-based income decreases the operational sustainability of a CDFI, because the definition only takes into account activity earnings (i.e. interest rate and borrower fee income and interest income on bank deposits).

However, whilst customers will always pay interest and fees for their loans, there may be more uncertainty in terms of the willingness of local government, housing associations and government departments to pay for services such as home improvement loans and money advice. For example, in light of the recent abandonment of the decent home standard by the UK government, local authorities may be less interested in funding home improvement loans.

It is also important to note that here we do not take into account bad debt provisioning and debt written off. The reason for this is that the CDFIs operate with very different bad debt and write-off policies, which would render the data incomparable. In particular, one CDFI (CDFI C) does not operate with a bad debt ratio. When we turn to plotting future scenarios, we apply a standardised bad debt ratio, which we take into account when calculating the operational sustainability ratio.

Chart 14: Overall operational sustainability



Source: Audited accounts for the calendar year of 2006 or for the financial year of 2006/2007

Chart 14 shows that the CDFIs are some way away from covering their costs exclusively through the income generated from their loan portfolios. The average for the personal lending CDFIs is below 40% and the most sustainable CDFI has an operational sustainability of just above 60%. However, compared to other UK CDFIs, the CDFIs in the sample perform reasonably well. The average operational sustainability for the personal lending CDFIs surpass those of Aspire (32%) (Forster et al, 2006) and Street UK (7%) (New Economics Foundation, 2004). The average for the personal lending CDFIs is slightly above the average for the UK CDFIs surveyed by the CDFA at 37.2% compared to 36% (Brown and Nissan, 2007).

The figure further suggest that CDFI A and CDFI E are the most sustainable CDFIs in that they are able to cover just over and under 60% respectively of their income through interest rates, fees and bank interest earned. However, CDFI E is mainly able to do so because of the bank interest it earns. The income from interest rates would only cover around 6% of its costs, though it is worth emphasising that we have not included the contracted support in the form of local authority subscription fees. In the case of CDFI A, bank interest earned plays a marginal role in explaining its performance, as even without bank interest, the organisation would still be able to cover around 60% of its costs.

CDFI B has the lowest score by some margin. This may in part be explained by its money advice programme. The costs of running this program are covered exclusively through contract income as opposed to customer fees, but it has proved impossible to separate out the money advice costs and income in this analysis. However, the costs and income related to this service will be separated out when we turn to the projections. Also, this was only the second year of operation of the CDFI. One might expect that as the organisation reaches greater maturity its performance may improve.

5.3 How sustainable can the CDFIs become – future development trajectories

So far we have examined the current level of operational sustainability of the CDFIs. However, given that the personal lending CDFIs are relatively young organisations at an early stage in their development trajectory, a more interesting question may be how far along the sustainability continuum they can progress over the next few years.

Therefore, in this section we attempt to project several possible future development trajectories for the CDFIs.

Drawing on the basic cost structure (staff, governance and office costs), loan and product portfolio mix (average amounts, number of loans, split repeat/new loans, interest rates, fees etc), and capital and funding streams (liabilities, financial expense, funding contracts) of the CDFIs for the financial year of 2006/2007, we made projections about the future growth and performance of the CDFIs for the following seven financial years: 2007/2008 through to 2013/2014.

In addition, we also had to make some assumptions about the future behaviour of the organisations and the climate in which they operate. We assume an annual growth rate in the number of personal loans issued of 10% and a 5% annual increase in the average value of the loans. The exception to this is CDFI D, which plans for its personal loan portfolio to be a smaller part of its business model in the future, where we have set an annual growth rate of 5%.

For business loans, regional variations in funding models and uncertainties about the market potential have made it difficult to set a standard growth rate. Therefore we set different growth rates for CDFI B (10%), CDFI D (5%) and CDFI C (0%) according to their business plans. The average value of the business loans is set to increase by 5% per year.

The overheads costs and capital requirements are adjusted to support these growth rates. We also apply an annual inflation rate of 4% throughout the period. In terms of capital requirements, we have assumed that interest free capital is available to support projected growth. Issues concerning capital requirement and potential funding sources are discussed in more detail in Section 5.3.5.

Furthermore, we have applied a standard bad debt ratio of 15% (10% for repeat clients) for both business and personal loans, and a ratio of 0.5% for home improvement loans. The CDFIs operate with different bad debt ratio policies. However, the standard bad debt ratio was applied to all the CDFIs because discrepancies in such ratios may skew the results, as the lower the bad debt ratio the greater the predicted interest rate income and vice versa.

Finally, we have also factored in planned opening of new branches and other structural changes. Opening new branches is likely to have a low initial income versus costs, as it requires initial investment and it may often take time before a new branch is able to build up momentum in terms of customer streams.

In addition to these base budget projections, we imagine that the CDFIs have a set of levers at their disposal to improve their level of operational sustainability which we analyse in the subsequent sections. They can lower costs by boosting staff productivity, increase the income earned on their products by raising the interest rates charged and add new products or alter the mix of products offered. In addition, we model a set of scenarios concerning recapitalisation, funding shortages and implications of borrowing loan capital at market rate on the CDFIs' sustainability.

5.3.1 Raising interest rates and loan officer productivity

To enhance the overall operational sustainability, the CDFIs can increase operating revenue through raising the interest rates and by cutting costs by increasing loan officer productivity (as measured by number of loans processed per full-time loan officer per year). These are demonstrated by Charts 15-19 which depict three scenarios. (Operational sustainability is displayed on the vertical axis, whilst financial years 2007/2008 to 2013/2014 are displayed on the horizontal axis.)

In the first scenario (as now) the CDFIs make no changes in productivity, interest rates levels or any other aspect of their operation. In the second scenario the CDFIs raise the loan officer productivity. For personal loans this entails raising the loan officer productivity to 400 loans per full-time loan officer up from 308 (CDFI B), 205 (CDFI C) and 250 (CDFI D). The 400 loans per full-time officer is the loan officer productivity for CDFI A which is the highest in the sample (see Section 3.5.2). The CDFIs increase the business loan officer productivity from 50 (CDFI B) and 60 (CDFI C, CDFI D) to 70 loans per year per full-time loan officer. Home improvement loan officer productivity is raised from 60 to 70.

In the third scenario the CDFIs raise the interest rates, and introduce or raise an administration fees. The CDFIs raise the personal loan interest rate to 31.9% from between 21 and 25% and raise or introduce an administration fee of 5%. This is a relevant scenario as one of the CDFIs is planning to increase its interest rates to 31.9% and to introduce a 5% administration fee from 2008. For CDFI E, we raise the interest rate from 6% to 8%.

It is important to note that CDFI D is currently radically reducing its overhead costs through reducing staffing. Unfortunately, these changes were brought to our attention too late to reflect them in all the modelling. These changes would have boosted the operational sustainability ratio considerably in all projections. That said the implications of these changes are explored in Section 5.3.3 when we look at best practice sustainability models.

Chart 15: CDFI A

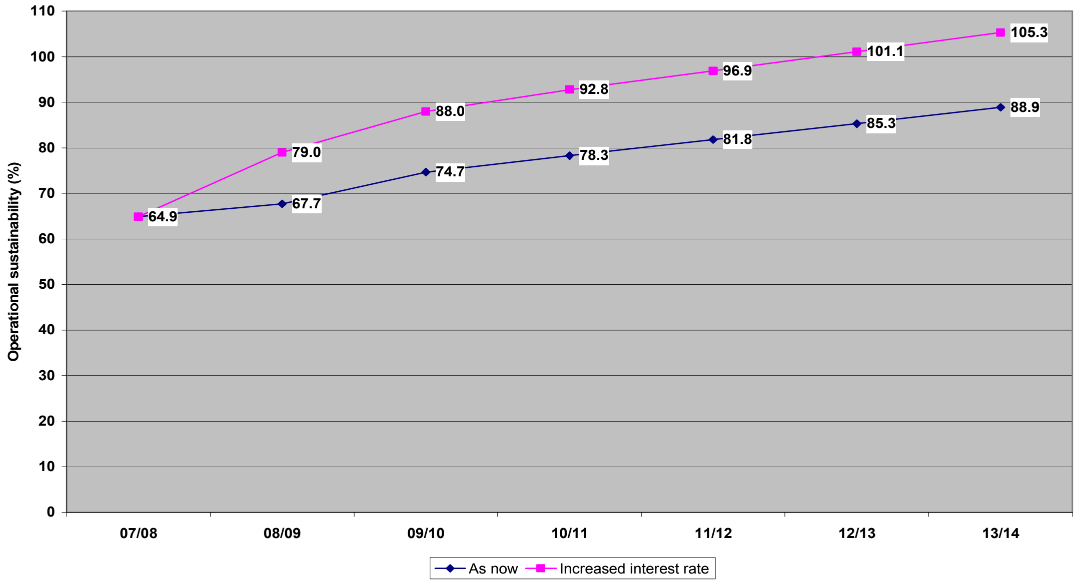


Chart 16: CDFI B

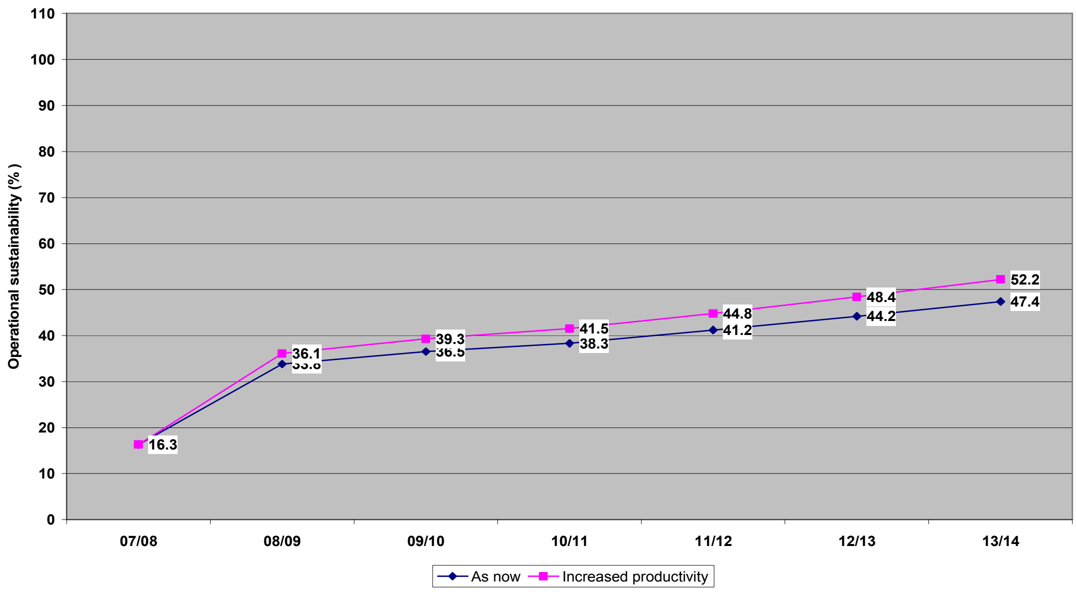


Chart 17: CDFI C

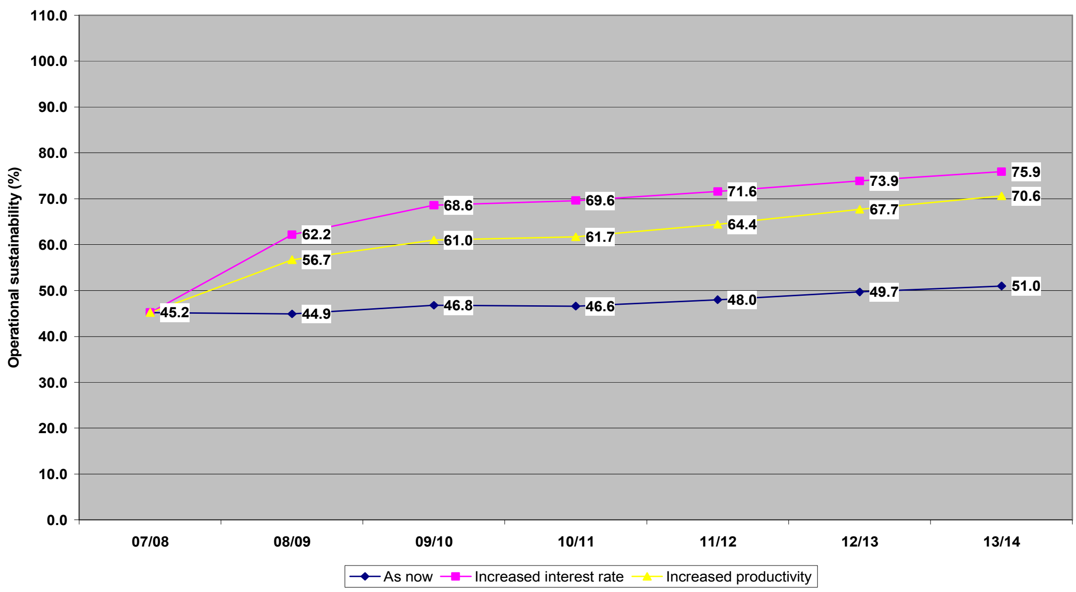


Chart 18: CDFI D

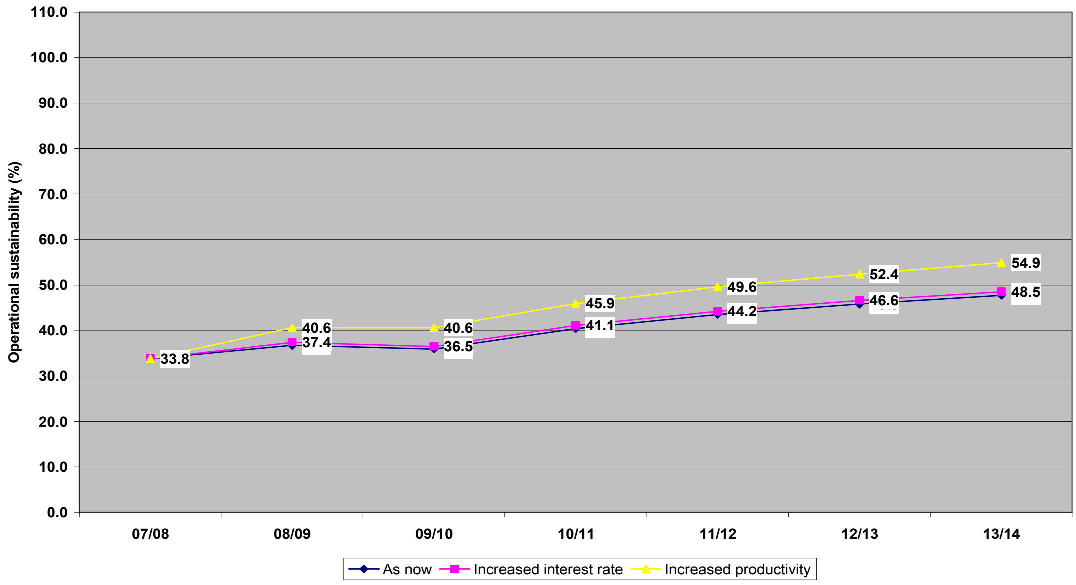
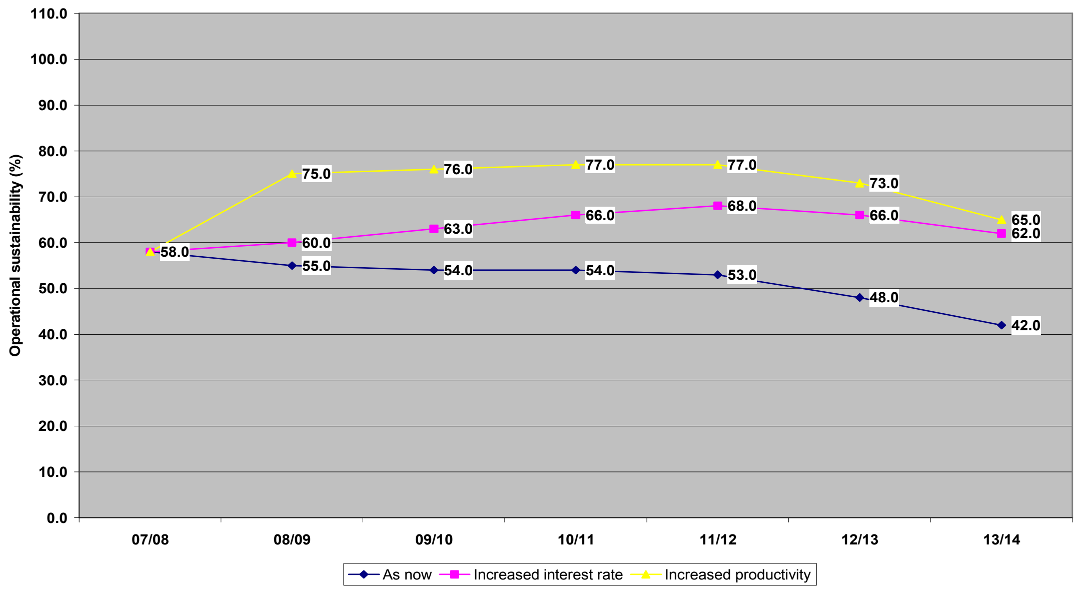


Chart 19: CDFI E



Generally, the CDFIs appear to be gradually enhancing their ability to cover their operating costs with income from fees and interest rates in all scenarios including the scenario "as now." Conversely, CDFI E shows a decline in operational sustainability. This is largely explained by the properties of the home improvement loan. At the start of the cycle of the home improvement loan, the local authority transfers a considerable amount of loan capital to the CDFI. The idea is that the CDFI can use this fund to borrow further capital for on-lending so that in the end the local authority contributes with around three quarter of the capital to be lent for the purposes of home improvement and the CDFI raises the remainder.

In the case of CDFI E, resulting from the immediate transfers from subscribing authorities, the CDFI has nearly £3 million in bank deposits at the start of year 2007/2008. These initial funds and the income from bank interests drop throughout the period as they are used for on-lending. By year 2011/2012 these initial funds are depleted, and for the years 2012/2013 and 2013/2014 the CDFI has to borrow capital for on-lending, hence the considerable drop in operational sustainability for this period.

Essentially, this shortfall has to be made up by local authority subscription fees. However, by raising interest rates and increasing loan officer productivity, CDFI E may be able to reduce the local authority subscription fees and make the home improvement loan package more attractive for local government as depicted in chart 19.

CDFI A comes closer than the other CDFIs in reaching 100% operational sustainability by the end of the projected period. There appears to be numerous explanations for this. First, CDFI A has the most efficient and streamlined organisational structure as illustrated by its high loan officer productivity. Second, the CDFI has lower overhead costs relative to the others, partly owing to lower labour costs per worker than the other CDFIs. Third, with the exception of CDFI B, CDFI A has the highest interest rates and administration fees. Fourth, the organisation seems to have made considerable gains in efficiency through outsourcing key activities, such as arrears monitoring. Finally, more than half of the loans CDFI A granted in the financial year of 2006/2007 were to repeat customers. Such loans constitute considerable cost savings as well as being lower risk.

Nevertheless, the graphs suggest that by boosting interest rates, raising or introducing administration fees, and by boosting loan officer productivity, all CDFIs can enhance their projected future performance. In particular, the introduction of an upfront administration fee for personal loans has positive implications for operational sustainability. The advantage with such a fee is that it is not affected by arrears and as such can give a disproportionate boost to income.

According to our estimates, over 40% of the total activity earnings (interest rate and fee income) for the personal loan portfolio of CDFI A in year 2007/2008 will be derived from the 5% upfront administration fee. Similarly, the 3% upfront fee charged from CDFI D customer will make up 36% of the activity earnings of the CDFIs personal loan portfolio for the same year.

The effectiveness of raising fees and interest rates, and increasing loan officer productivity for the individual CDFI depends on three factors. First, the starting point of the CDFI will affect the gains a CDFI can make in terms of operational sustainability. A CDFI closer to best practice will have less to gain by raising interest rates and productivity than a poorer performing CDFI.

Second, the mix of products will also have an impact on the improvements a CDFI can make. As we make a greater number of and more radical alterations to the personal loan portfolio, the impact will be most felt by the CDFIs with a stronger concentration on personal lending in terms of the value of the loan portfolio.

Finally, how far a CDFI can move towards full operational sustainability may ultimately depend on the level of overheads. This is particularly the case for CDFI B and CDFI D, who have both considerably higher governance and, particularly, staff costs. We discuss this in more detail below.

Thus, we can observe that CDFI C, who has a low starting point in terms of interest rates and loan officer productivity, in particular is in position to make considerable advances in operational sustainability over the next 7 years by introducing an administration fee, increasing the interest rates and boosting loan officer productivity.

5.3.2 Adding home improvement loans

A mixed portfolio may make for a less vulnerable and potentially more profitable CDFI sector. In particular, home improvement loan is thought to have a positive impact on the overall portfolio. It is a high ticket, low risk product. As the local councils often subsidise the interest rate it is also an attractive option for consumers in that such a loan is likely to be cheaper than loans offered by other financial providers.

It must be noted that, at least in the medium term, the delivery of the home improvement loan is dependent on local authority subscription fees. However, if local authority is interested in upgrading housing stock to decent housing standard, then home improvement loan may be a cost-effective manner of upgrading the local housing stock.

Thus in this section we model how the CDFIs would perform if they were to include home improvement loans (Charts 20-22). These scenarios are only relevant for the CDFIs without home improvement loans (i.e. CDFI B, CDFI C and CDFI A). We have factored in a 12 month planning process, so the home improvement loan scheme does not come into effect until April 2009. Furthermore, we will not include any costs related to start-up. However, such costs are likely to be covered through public and private sector grants.

We assume that the CDFIs can make 41 home improvement loans at an interest rate of 8% and at an average value of £5,500 in their first year of operation (2009/2010). The number of loans will increase by 10% in the following years and will increase in average value by 5%.

Chart 20: CDFI A

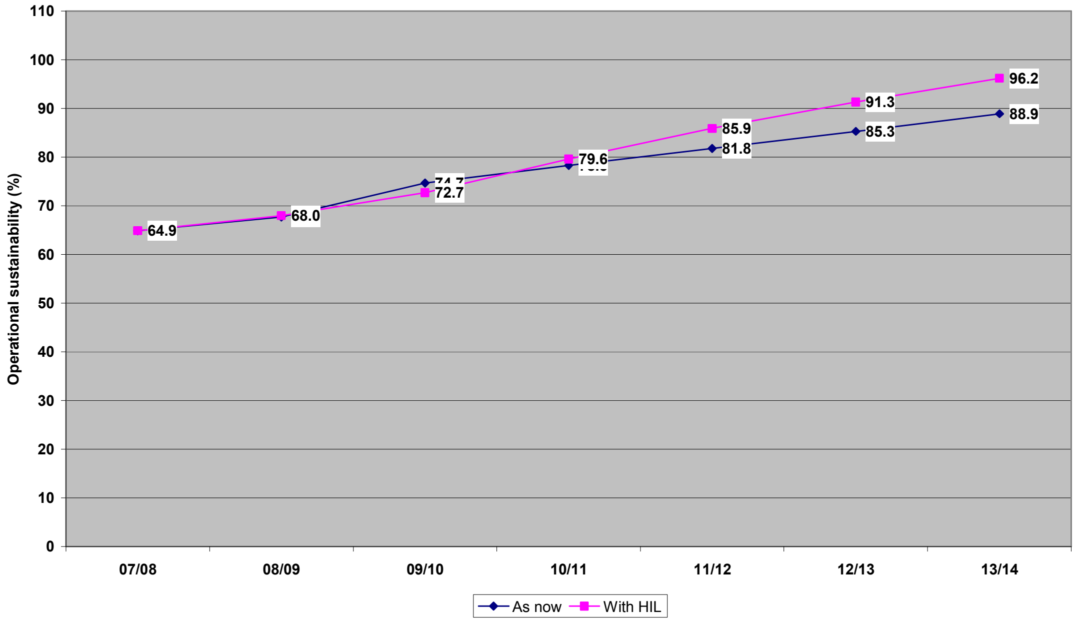


Chart 21: CDFI B

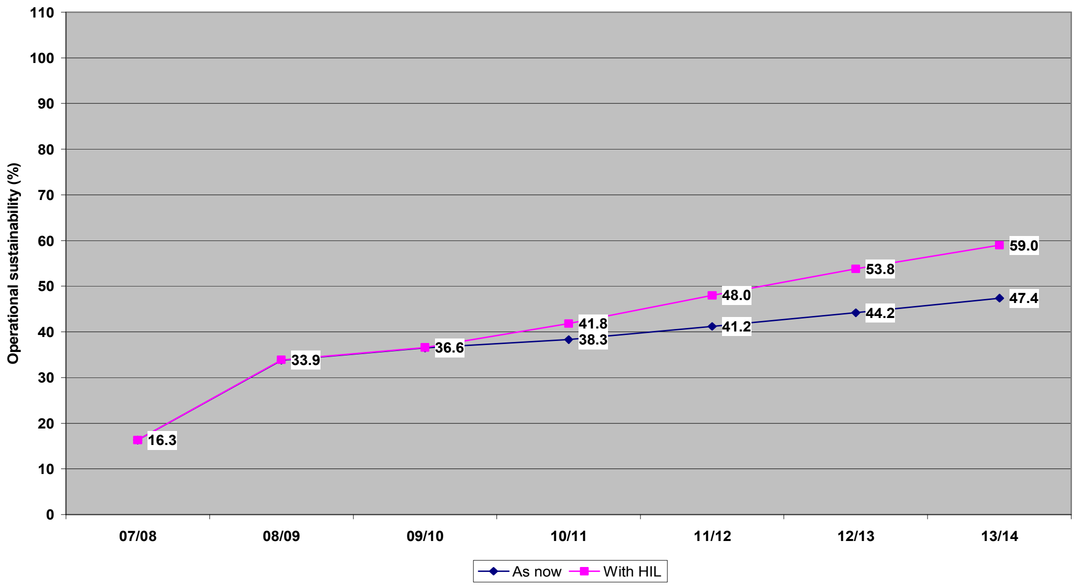
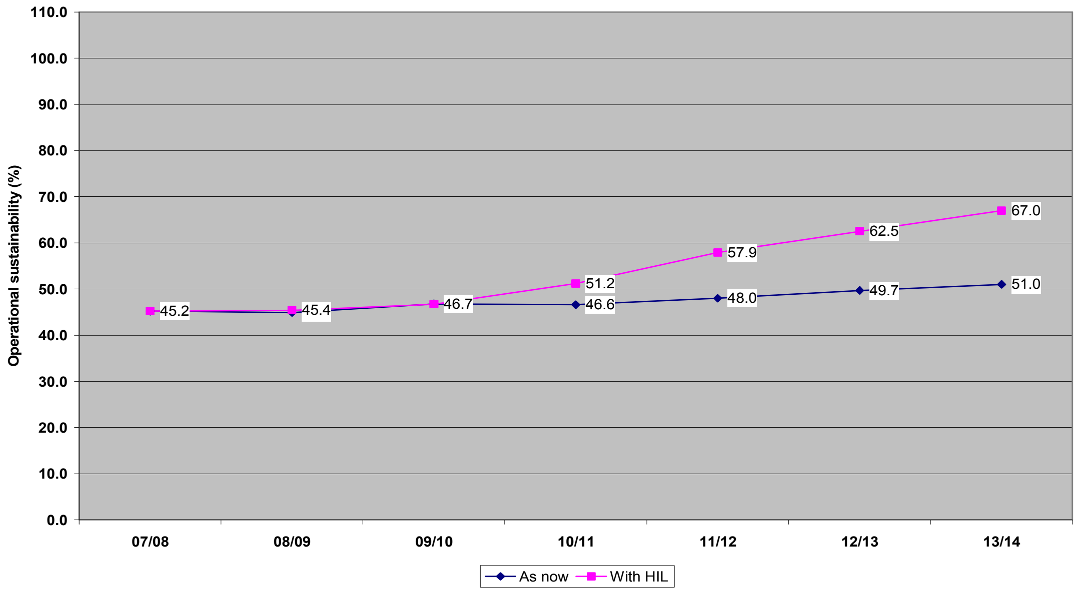


Chart 22: CDFI C



Despite these relatively modest assumptions, the charts suggest that all CDFIs could boost their operational sustainability by introducing home improvement loans. Given that we have assigned the same assumptions to all the CDFIs, and that the home loan improvement product gives the same absolute activity earnings, the CDFIs with the smallest portfolios in absolute terms have the most to gain.

The home improvement loan product results in just below £9,000 in earnings from interest rates in its first year (2009/2010) and just above £90,000 in year 2013/2014. For CDFI A, whose total activity earnings (income from interest rates and administration fee charged) for the same years are approximately £250,000 and £450,000, such an income will make less impact on sustainability than for CDFIs with smaller portfolios, such as CDFI B and CDFI C.

5.3.3 Towards a best-practice model of operational sustainability

In this section we model how close to full operational sustainability the CDFIs could get over the next seven years were they to adopt best-practice in terms of interest rates and administrations fees, loan officer productivity and product mix (i.e. introducing home improvement loans) (Charts 23-27). For CDFI D (Chart 26), we have also added a best practice scenario reflecting recent changes to the organisation's staff cost structure (reduced overheads). CDFI D is currently in the process of reducing their staff costs by nearly £100,000 through cutting number of staff boosting operational sustainability considerably. We discuss the implications of these alterations below.

Chart 23: CDFI A

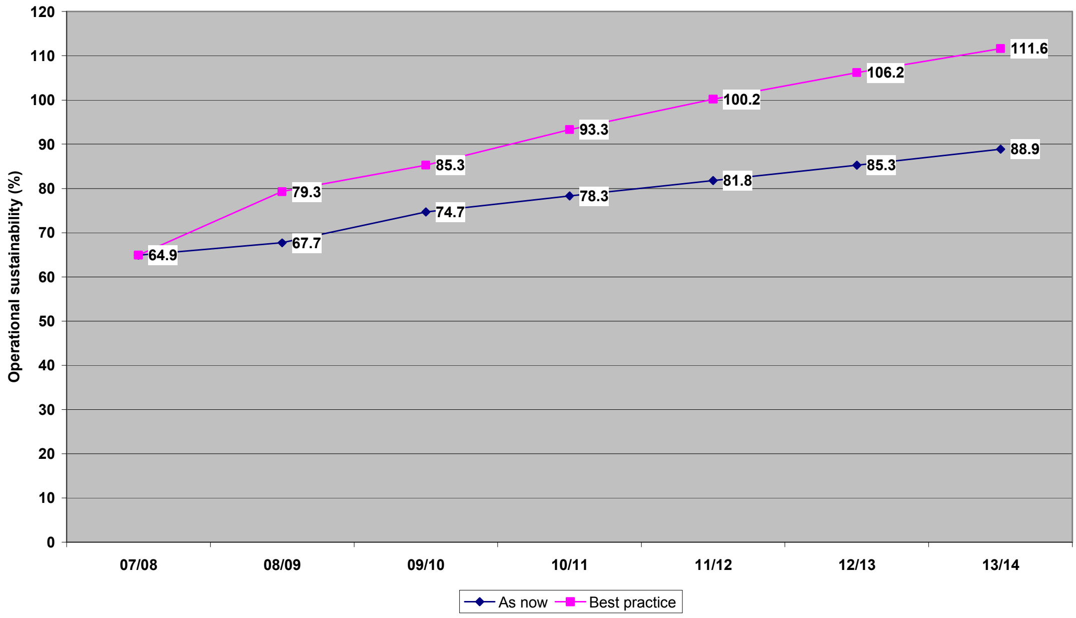


Chart 24: CDFI B

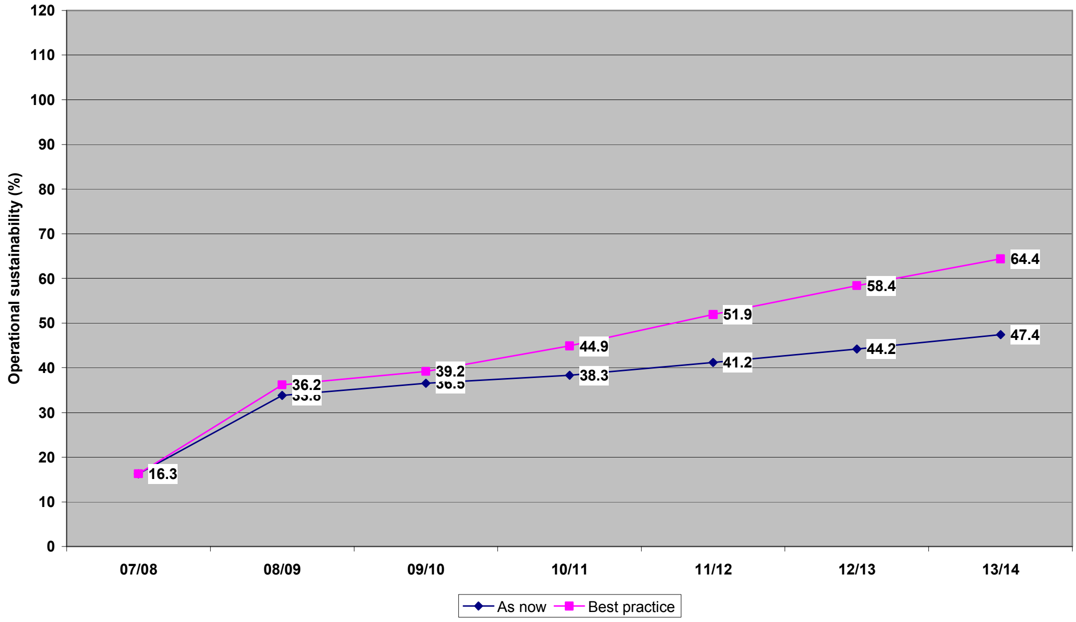


Chart 25: CDFI C

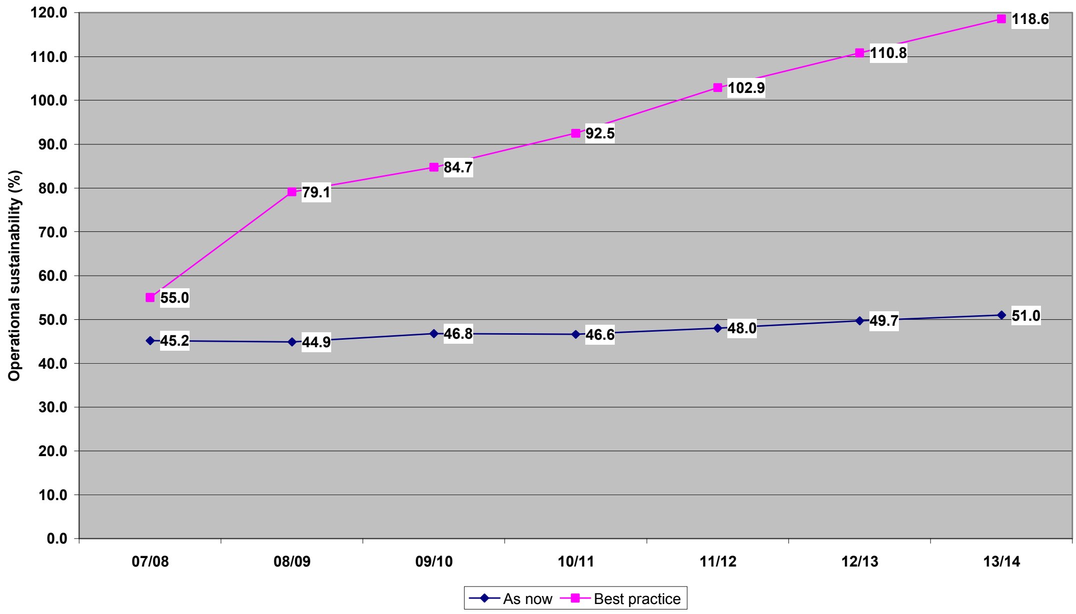


Chart 26: CDFI D

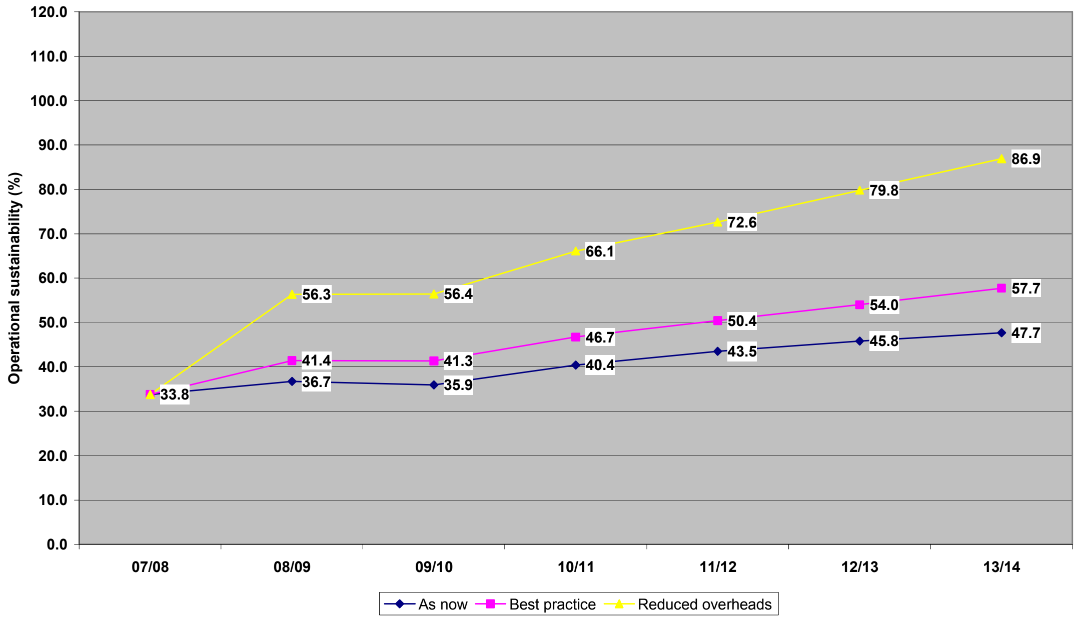
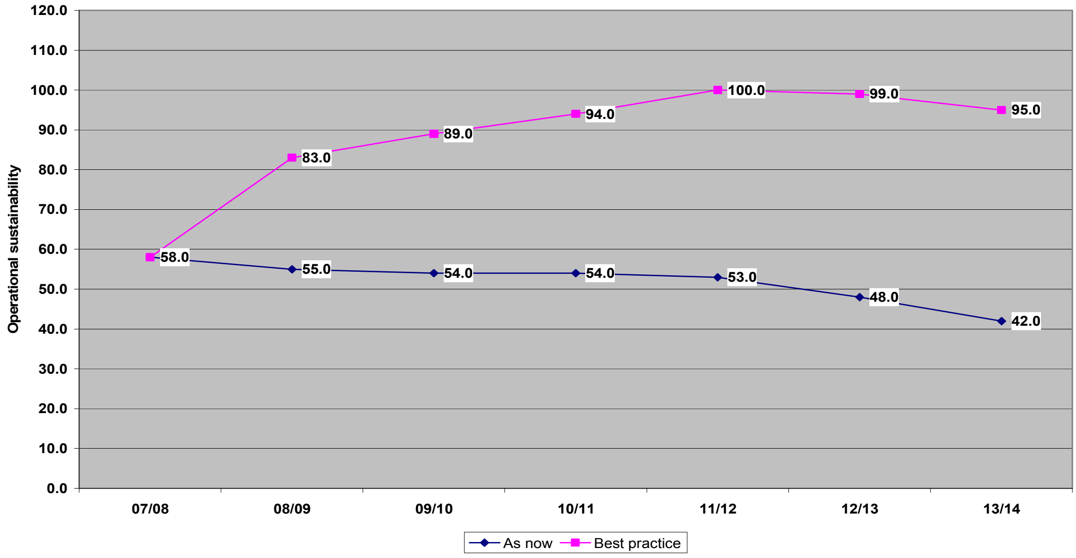


Chart 27: CDFI E



The charts suggest that by adopting all the best-practice measures – raising interest rates and administration fees, boosting loan officer productivity and introducing the home improvement loan – the CDFIs can make considerable improvements on the sustainability of their organisations.

Two of the CDFIs – CDFI C and CDFI A – reach full operational sustainability in 2011/2012. CDFI C experiences the most radical improvement. The main explanations for this are the relatively low starting point and the relatively small size of its loan portfolio.

The charts also show CDFI C surpassing CDFI A by year 2011/2012. This is because of the business loan portfolio, which although stagnant in the number of loans issued, constitutes nearly 20% of income from interest rates and fees. This suggests that, providing the business portfolio bad debt remains at manageable levels (around 15%) and the average loan value increases (5% per annum), even a moderate number of business or other higher ticket loans (24 per year in the case of CDFI C) can make a considerable contribution to operational sustainability. A back-of-the-envelope calculation indicates that dropping the business loan portfolio may lead to as much as a 15-18% decline in the level of operational sustainability in the seven year period.

CDFI E also reaches full operational sustainability in 2011/2012 but falls below for the following two years mainly due to the fact that the CDFI starts borrowing for on-lending as stipulated in the home improvement loan cycle. However, despite the slight fall in operational sustainability in years 2012/2013 and 2013/2014, the chart suggests that by raising the interest rates and the number of loans processed per loan officer, the proportion which needs to be covered by local authority subscription fees decrease drastically.

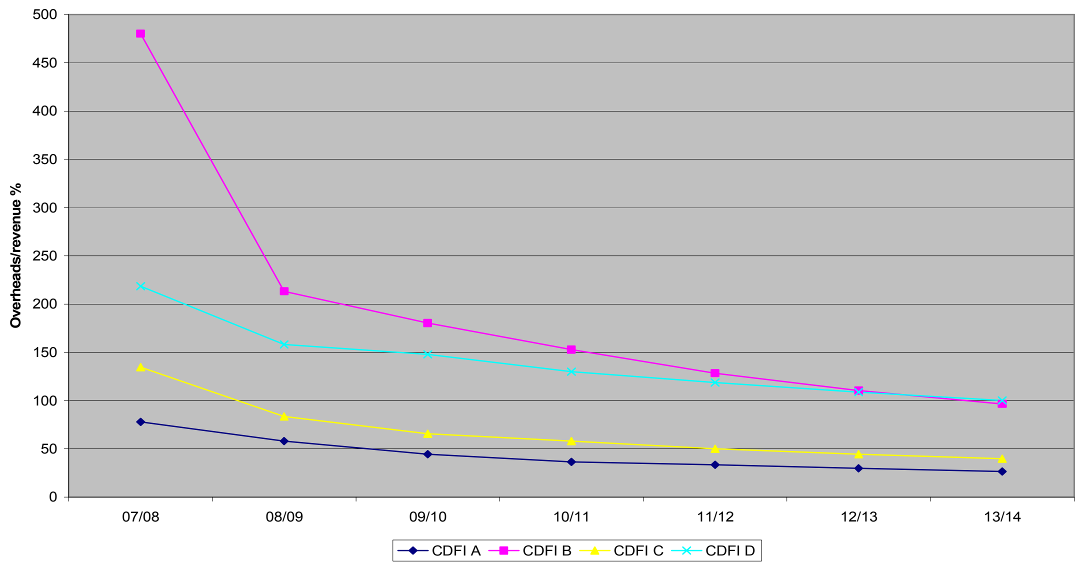
CDFI D and CDFI B make smaller gains by adopting best-practice than is the case with the other CDFIs. In the case of CDFI B, the CDFI already had a reasonably high personal loan officer productivity (of around 300 per year per full-time personal loan officer) and has the highest interest rate and administration fees among the CDFIs. Therefore, the CDFI experiences a less dramatic, though still very considerable improvement in operational sustainability. For CDFI D, given that the CDFI already operates with a home improvement loan product and given the scaling back of the personal lending in relative terms – we assume that the CDFI grows by 5 opposed to 10% – there is also less dramatic improvements.

5.3.4 The impact of overheads on operational sustainability

Indeed, it is notable that, even by adopting all the proposed changes, CDFI B and CDFI D only reach around 60% operational sustainability by the end of the seven-year period (2013/2014). A closer examination of the organisations suggests that the high overhead costs of these two CDFIs act as brake on improving operational sustainability.

Chart 28 displays the unallocated overheads – that is the staff, office and governance costs not directly related to the delivery of the core services (personal, business and home improvement loans, and money advice) – as a percentage of total activity earnings (interest rates and fees paid by borrowers, and bank interest income on deposits) for the best practice scenario for the personal lending CDFIs.

Chart 28: Overheads as proportion of activity revenue



It shows considerable discrepancies for the personal lending CDFIs. By the end of the seven year period (2013/2014), the ratio for CDFI D and CDFI B is 100.1% and 96.6% compared to 26.5% for CDFI A and 39.8% for CDFI C. In other words, even by the end of this period, the overheads for these two CDFIs are nearly four times as high relative to activity earnings compared to CDFI A and more than twice as high compared to CDFI C. The sharp decline in the ratio experienced by CDFI B is due to a strong portfolio growth associated with the opening of new branches.

There may be several explanations for the much higher overheads for CDFI D and CDFI B. First, the product portfolios of these CDFIs differ considerably from that of CDFI C and CDFI A in that they to a greater extent involve the delivery of services for government departments, local authorities and housing associations. A high reliance on contractual as opposed to customer-based income decreases the operational sustainability of a CDFI because the definition only takes into account activity earnings (i.e. interest rate and borrower fee income and interest income on bank deposits).

CDFI B runs a money advice programme which is fully funded by grant income from the BERR, housing associations and other organisations. In developing the possible future development trajectories, we have in effect removed the direct costs relating to the delivery of the money advice programme, so that these direct costs do not affect the overall sustainability. Nevertheless, it has proven difficult to separate out the exact office and governance costs related to the delivery of this service, so the money advice service may still have an impact on the overall sustainability.

For CDFI D, the delivery of the Growth Fund contract is particularly complex involving seven sub-contractors. For example, considerable time and effort goes into training of subcontractors and in ensuring that the correct data is collected. For this reason 80% of one of the management positions is funded by the Growth Fund. Furthermore, including the home loan subscription fees paid by the local authorities would have lowered the ratio of unallocated overheads as a proportion of activity earnings.

Nevertheless, even if we take into account contractual income when estimating unallocated overhead costs as a percentage of earnings, there is still a considerable discrepancy. At the end of the period (2013/2014), the ratios for CDFI D (48%) and CDFI B (52.9%) are still twice as large compared to CDFI A (24.7%) and CDFI C (26.4%).

Second, the high overhead costs may partly be a product of higher operation costs such as wages and cost of renting premises in the areas where CDFI B and CDFI D operate. For CDFI D, the labour costs are considerable. The unallocated labour costs (i.e. labour costs not directly related to the delivery of a loan product) alone constitute 45.6% of CDFI D’s activity earnings, compared to 28.9% (CDFI B), 14% (CDFI C) and 4% (CDFI A).

Clearly, such overhead costs may be difficult to deal with, as CDFIs to some degree are price-takers in that they have less leeway to determine the price of premises and staff. Nevertheless, it may be interesting to look at the potential impact of reducing overheads. By shaving £100,000 of the unallocated overhead costs for CDFI D and CDFI B (down from approximately £270,000 and £210,000 at the beginning of the period respectively), the CDFIs reduce their unallocated overhead costs as a percentage of activity earnings to 32.7% and 30.3% respectively by year 7 (2013/2014).

In turn, by applying these new unallocated overhead costs to the best practice development trajectories, the operational sustainability level of CDFI D and CDFI B increase considerably. CDFI B improves its operational sustainability by more than 20% to nearly 90% in year 2013/2014. Interestingly, CDFI D is currently in the process of downsizing its staff and reducing its costs by nearly £100,000. As a consequence of these changes the operational sustainability ratio soars by nearly 30% to over 85% in year 2013/2014 (see Chart 26).

5.3.5 Future capital requirements, models of recapitalisation and implications for sustainability

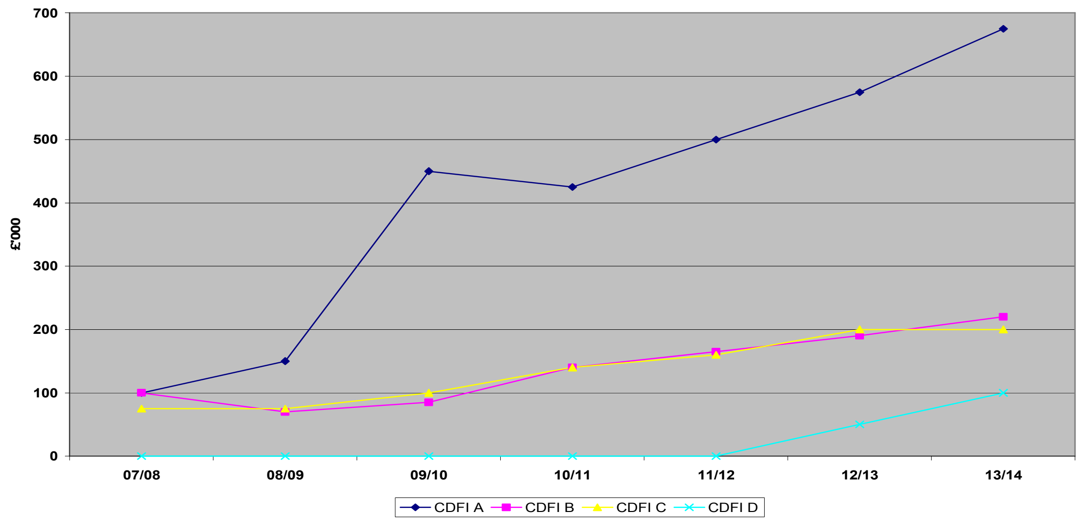
So far we have assumed that the CDFIs have access to interest free capital for on-lending. However, a potentially very important barrier for the expansion and future sustainability of the sector may be the availability of lending capital. Currently the CDFI sector is not able to offer deposit services, except on an agency basis, and even if they were, it is questionable the extent to which the funds raised through medium and long-term savings products would be able to significantly contribute towards loan capital.

One way in which policy-makers and funders can strengthen the sector's capacity for growth and wean the sector of its dependence on granted loan capital is by enabling CDFIs to borrow lending capital from banks through a guarantee fund. Such a fund would essentially protect the lender against bad debts up to a certain percentage. Internationally, numerous CDFIs, or Microfinance Institutions (MFIs) as they are called, borrow lending capital. Also the UK mainstream financial sector relies to some extent on borrowing lending capital.

Therefore in this section we analyse and discuss the ability of the CDFIs to fund their own growth through recycling existing funds and the implications of covering any subsequent funding gaps with commercial loans on their operational sustainability.

Chart 29 displays the size of the gap in funding (expressed in £'000) to support a 10% annual growth in their personal loan portfolio using best-practice approaches (e.g. in terms of interest rates, productivity and home improvement loans), once the CDFIs have recycled their existing loan capital (i.e. the opening balance at the beginning of 2007/2008). Here we exclude the capital requirements for the home improvement loan given that there are particular funding arrangement in which it is given that the CDFI borrows to on-lend part of the home improvement loans.

Chart 29: Future capital requirements



Unfortunately, given that a detailed analysis of future grant funding of the individual CDFIs was outside of the scope of this research project, it has not been possible to ascertain exactly how much of this funding gap the CDFIs have managed to bridge through grant funding. However, it is worth noting that the second round of the DWP Growth Fund is set to end in 2011.

The chart reveals a considerable funding gap. Already in Year 1 (2007/2008), CDFI A experiences a six-digit funding gap, whilst CDFI C has a shortfall of £75,000. The figures for CDFI B are similar to CDFI C, whilst CDFI D first experiences funding shortages in year 2011/2012 because of its slower projected volume growth in personal loans and considerable reserves.

The future capital requirements for CDFI A are considerably greater than those of the other CDFIs, because of the much greater scale of its operation. For example, according to our projections, CDFI A will lend out more than £1 million in personal loans alone in year 1 (2007/2008) and over £3.5 million in year 7 (2013/2014). In comparison, CDFI C will make loans (business and personal loans) for less than £350,000 in year 1 and less than £900,000 in year 7.

In particular, CDFI A experiences a hike in its future capital requirements in year 3 (2009/2010). This is related to the opening and maturation of new branches, specifically to one branch of CDFI A. This branch was opened early 2007 and is likely to take a few years to build up momentum. By year 2 (2008/2009) it is expected that the branch will have caught up with the level of the main office, which is the oldest branch with the highest level of business, in terms of new personal loans. In year 3 (2009/2010), the branch is projected to have caught up with the level of repeat business of the main office, which is the most important cause of the sharp rise in capital requirements.

In summation, the chart suggests that a recapitalisation strategy based exclusively on recycling existing loan capital is not a viable means of supporting the expansion of the sector. The sector is dependent on raising funds through grants, contract income and through borrowing loan capital.

Whilst grant funding, such as the Growth Fund 2, is likely to be available in the short to medium term, in the longer term interest-free loan capital may be scarcer, particularly for the purposes of scaling up the personal lending CDFI sector. Therefore, in the medium to long term, as the CDFIs reach a greater degree of maturity, a future recapitalisation strategy may centre on borrowing capital for on-lending. One could envisage that this is facilitated through a guarantee fund or through direct loans from the funders.

Thus in this section we discuss and analyse the implications of borrowing part or all of the future loan capital requirements (i.e. total capital to be lent out less recycled capital) on the sustainability of CDFI A and CDFI C. Here, we have here only focused on these two CDFIs because they are closest to full operational sustainability by year 7 (2013/2014). The rationale behind this is that the CDFIs may need to reach full or at least make strides towards full operational sustainability, to convince a mainstream financial institution to lend or to convince a funder to make available a guarantee fund.

Charts 30 and 31 depict three scenarios. All the scenarios depicted assume that the CDFIs operate with the highest loan officer productivity, the greatest interest rates and with home improvement loans. In the first scenario – best practice – we assume that the CDFIs can fund 100% of their capital requirements through granted loan capital.

In the second scenario – financial sustainability – the CDFIs have to raise 100% of their capital requirements through recycling existing funds and through borrowing loan capital at an interest rate of 7%. The reason for calling this scenario financial sustainability is that it accurately reflects the definition: the ability to cover all costs through activity earnings (customer interest rate and fee income + interest income from bank deposits) whilst raising all lending capital through recycling existing funds and through commercial loans.

In the final scenario – if borrow 30/60% – we look at the impact on their sustainability if the CDFIs borrow 30% (CDFI A) and 60% (CDFI C) of their capital requirements at a 7% interest rate. These percentages are estimated as the proportion of future capital requirements the CDFIs would be able to service as a loan and still reach full sustainability in year 7 (2013/2014).

Chart 30: Borrowing loan capital - CDFI A

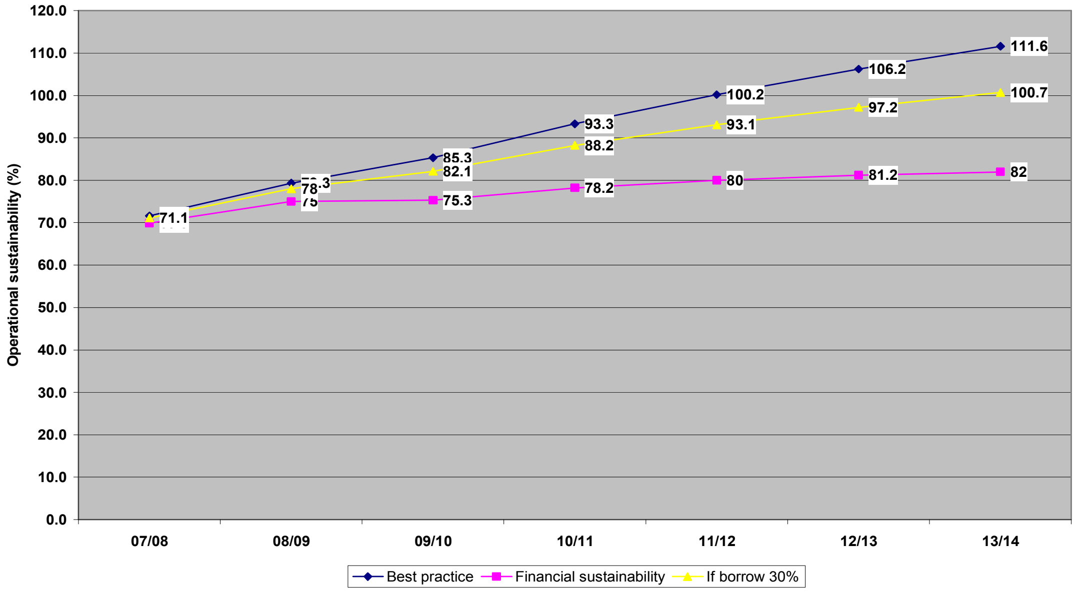
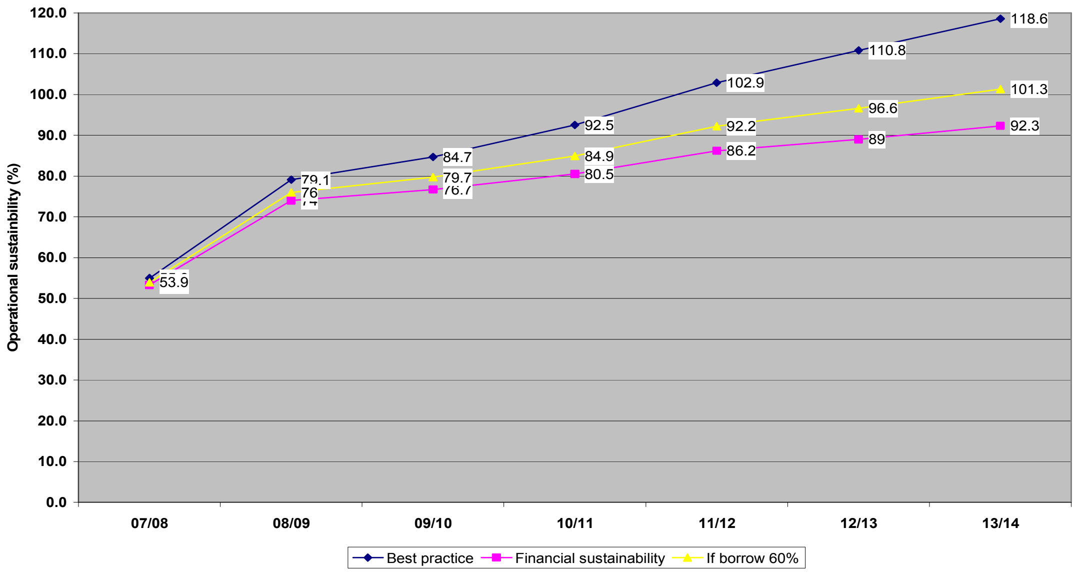


Chart 31: Borrowing loan capital - CDFI C



The charts suggest that borrowing loan capital is likely to have more adverse effects on CDFI A compared to CDFI C. This is largely because of the greater capital requirements of the former. According to our estimates, CDFI A will need to raise over £2.8 million in lending capital to cover the projected growth of its personal loan portfolio over the seven year period, compared to less than £1 which CDFI C need to raise to maintain its business loan portfolio and meet its growth projections for personal loans.

The charts further highlight that, providing they can achieve the projected growth and implement changes to their operations, both CDFIs move reasonably close to financial sustainability by the end of the period. Although none of the CDFIs reach full operational sustainability in the seven-year period, CDFI A and CDFI B may borrow 30% and 60% of its loan capital, respectively, and still reach full sustainability in year 7 (2013/2014).

6 CONCLUSIONS AND RECOMMENDATIONS

6.1 Loan portfolio analysis

The analysis of the loan book suggests that the CDFIs are some way from covering their costs exclusively through the income generated from their loan portfolios. The most sustainable CDFIs in the sample are able to cover just over 60% of their costs through interest rates, fees and bank interest earned. Four out of the five CDFIs in our sample either come close to or surpass the performance of Aspire in Northern Ireland and Street UK. Three of the CDFIs also perform better than the average performance of the UK CDFI sector according to the latest CDFA industry survey.

The results of the financial modelling indicate that over time the CDFIs are improving their performance even if they make no changes to the way they operate. However, the CDFIs can, depending on their starting point and mix of products, make considerable improvements by adjusting interest rates and fees, and by increasing productivity. However, we also found that high overhead costs relative to activity earnings (interest income from bank deposits, income from interest and fees earned) can act as a break on sustainability.

The financial sensitivity analysis of future capital requirements and different models of recapitalisation suggest that raising loan capital purely through recycling existing funds is an unviable strategy to fund future expansion of the CDFIs in the sample. Already in the first year of operation without granted or borrowed loan capital, the most sustainable CDFIs experience considerable funding shortages.

Whilst borrowing capital for on-lending is, ceteris paribus, likely to lead to a decline in sustainability, two of the CDFIs may be able to borrow as much as 30 and 60% of their future capital requirements and still reach full sustainability by year 7 – providing the CDFIs raise interest rates and loan officer productivity, and introduce the home improvement loan.

6.2 Staff efficiency and productivity

The analysis of the way in which CDFI staff members spend their time suggest that there are striking differences in the productivity of the CDFIs in the sample. The prime indicator of this is that a personal loan officer at the most efficient CDFI grants 440 personal loans per year, which is more than twice as many as a loan officer at the least efficient CDFI and more than 100 loans more than the second most efficient CDFI in the sample.

The data suggest that there are three factors driving productivity. First, we found a strong relationship between the time the lending staff spent on direct customer contact and loan officer productivity. Provided there is sufficient demand for the products of the CDFI, by organising the non-lending in such a way to maximise the exposure of the lending staff and by allowing non-lending staff to step in for interviews when necessary, the CDFI can raise the loan officer productivity considerably. Our findings also suggest that part of maximising lending staff exposure to potential customers may also lie in outsourcing administrative aspects of arrears control and possibly other areas to external companies

Second, we also found that the loan officer productivity is crucially linked to the proportion of repeat clients. The CDFI which displayed the greatest loan officer productivity also had the greatest proportion of repeat clients. Repeat business involves lower transactions costs and generally constitutes a smaller risk for the CDFI.

Finally, the number of applicants a loans officer can interview is to some extent conditional on the availability of appropriate meetings rooms. For example, in the case of CDFI B, two loans officers and two debt advisors share one meeting room, which may limit the number of loan applicants a loans officer can see in the course of a working day. That said, unless the CDFI is able to generate sufficient demand for its products and put in place efficient processes to deal with this demand, investing in appropriate premises alone is unlikely to be sufficient to boost productivity.

6.3 Partnership effectiveness

The primary partner organisations of the CDFIs in the sample are local governments, housing associations and, banks and building societies. The cooperation mainly centres on marketing, funding and making referrals to the CDFIs. Many of the local authorities also cooperate with the sector on the provision of home improvement loans.

On the whole, the partner organisations perceive the CDFIs to be reliable and trustworthy partners, while there is less consensus on the degree to which their partnership is effective and helps them achieve their goals. Local authorities appear most uniform in the extent to which their partnerships with the CDFIs are formalised, in their knowledge of loan products and processes and generally display the highest level of satisfaction.

6.4 Recommendations

Our research suggests that many of the levers to enhance the sustainability and viability of the CDFI sector are in the hands of the CDFIs themselves. They can grow their loan books through marketing, effective partnerships and appropriate product design, they can cut costs through improving the efficiency with which certain products are delivered, they can add new products and they can increase interest rates and increase or introduce administration fees.

In particular, our findings suggest that there are certain structural and process-related changes which are likely to have a particularly positive impact on the sustainability of the CDFI sector:

1. *Charge interest rates which more closely reflect the costs involved in providing loans:* A closer relationship between costs and interest rates is likely to boost operational sustainability and decrease the CDFI sector's reliance on subsidies. This is important as we do not know for how long the national government and funders are willing to subsidise and fund the sector. In particular, charging an upfront administration fee for personal loans has positive implications for income from the loan portfolio. Such a fee is not subject to arrears and may contribute more than a fifth of the total interest rate and fee income. Ultimately, the positive impact of increased interest rates on the operational sustainability of the sector and its implications on the longevity of operations may outweigh the additional financial costs for the personal loan customers.
2. *Take steps to maximise lending staff's exposure to potential customers:* Our data suggests that there is a strong link between staff productivity and the degree of exposure of the loan officers to potential customers. In turn, loan officer productivity constitutes an important lever to reduce costs and increase sustainability without passing on the costs to the customers. There are two

main ways in which the CDFIs may be able to increase the amount of time lenders spend seeing potential customers. First, the CDFI may achieve this by organising the non-lending staff to take on all other aspects of the lending process and by allowing non-lending staff to step in for interviews when necessary. Second, by outsourcing activities such as arrears monitoring, the CDFIs may be able to free up staff time to deal with potential customers.

3. *Capitalise on links with other CDFIs to enhance innovation and reduce costs:* There are numerous advantages of closer cooperative ties between CDFIs. The CDFIs may learn different best practices of each other. In some cases, there may be a case for franchising certain products (e.g. home improvement loans). There may also be a scope for sharing start-up, one-off or other development costs (e.g. mortgage license, insurance license) related to new products or processes.
4. *Make the case for developmental rather than only sustaining funding:* Given the importance of appropriate premises and the cost-saving potential of investing in outsourcing mechanisms, the CDFIs may want to consider pushing for funders to cover such costs.

However, funders and policy-makers also have a role to play in shaping the future prospects of the CDFI sector. In particular, we believe that funders can underpin the future sustainability of the sector by offering:

1. *Development grants to stage-manage productivity improvements.* In particular, funders could facilitate the implementation of cost-saving and efficiency enhancing outsourcing mechanisms by smoothing potential implementation barriers. Similarly, funders may be in a position to enable certain organisations to move to premises more conducive for customer throughput.
2. *Development grants to launch new products*. This could include support for Research and Development, and for preparatory market and feasibility studies for the introduction of new products. In particular, where possible, the introduction of higher ticket, lower risk loan products (home improvement loans, car loans etc) is likely to have a positive impact on overall sustainability and making the sector less vulnerable to shocks adversely affecting the core activity of consumption lending

The results of the financial sensitivity analysis of the different recapitalisation models show that the sector's further expansion is dependent on capital being made available in the form of capital grants and loan finance. The mix of funding instruments will depend on the level of maturity and sustainability of the individual CDFI, loan finance being more appropriate for the CDFIs further along the sustainability continuum.

3. *Capital grants for loan capital*: To support an up-scaling of personal lending to benefit a larger number of financially excluded households, the personal lending CDFIs are, at least in the short and medium term, dependent on capital grants for loan capital. Such grants may give the CDFIs a time horizon to innovate and improve their organisations to reach the necessary level of sustainability to be in a position to borrow loan capital.
4. *Loan finance for on-lending*: In the medium to long-term, the funders may want to consider offering funds for on-lending in the form of loan finance for the CDFIs, especially for the more sustainable CDFIs. The prime advantage with loan finance as opposed to capital grants is that the fund is recycled and can be re-lent to the CDFIs.

5. *Capital/guarantee to underwrite bad debts*: Ultimately it may be better if the CDFIs borrow money from the mainstream banking sector rather than from scarce charity and government funding. However, the mainstream banking sector may prove reluctant to forward loan capital to a young sector with slim if any profit margins. A possible way to circumvent this difficulty is by establishing a guarantee to underwrite bad debts. Such a fund would protect the lender against bad debt up to a certain percentage.

In conclusion, since the first personal lending CDFI was founded based on the CRT model in 2000, the sector is still not able to retrieve all their costs with income generated from their core activity of lending. However, the CDFIs are capable of becoming more sustainable by setting interest rates which more closely reflect the costs of delivery and by organising staff to maximise loan officer exposure to potential customers. Moreover, with appropriate financial and technical support to underpin further portfolio growth, adopt higher-ticket loan products and implement cost-saving outsourcing mechanisms, the sector has the potential to move further along the sustainability continuum.

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