UK Finance Response to BEIS Committee Inquiry into Small Businesses and Productivity

March 2018

UK Finance is a new trade association which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK. It represents around 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Our objective is to work with our members to build a more customer-focused and innovative finance and banking sector, cementing the UK's role as a global leader in financial services for the benefit of the wider economy. The interests of our members' customers are at the heart of this work.

Introduction

The financial services industry is committed to supporting businesses, including through providing finance. Improving business productivity, addressing late payment and supporting high-growth Scale-Up firms have been the focus of significant attention in recent years and the Committee will no doubt reflect on the work that has already been done on these areas, as well as the opportunity for the Government to remain joined up in delivering the solutions identified to these challenges.

As the recent demise of Carillion demonstrated, many small businesses are ever more connected into increasingly complex supply chains. UK Finance's members took a number of immediate actions to support small business customers who were impacted by the liquidation, putting in place emergency measures, such as overdraft extensions, payment holidays and fee waivers.

As well as the immediate and on-going support provided by finance providers to businesses (and more broadly to individuals impacted), UK Finance believes it is right for the Committee to assess issues that have been highlighted by Carillion's collapse, especially so-called 'late payment' issues. The Committee will recognise this term is generally used to describe a range of poor payment practices, rather than simply paying suppliers outside agreed terms. Within this, we would also identify imposition of extended payment terms and other poor practices such as the imposition by large debtors of so called 'ban on assignment' clauses on smaller suppliers, which can restrict the finance options available to those small suppliers. In addition, charging suppliers to be set up on payment list and so called 'pay to stay' fees have been points of contention.

We have focused our input to this Inquiry on where our membership are best placed to provide commentary. However, it will be evident to the Committee through this Inquiry that many of the issues identified (including business skills, skills, productivity and leadership) are inextricably linked to improving the relative performance of UK businesses compared to international peers. The finance industry also plays an important role in supporting good practice with information and services.

UK Finance would also like to draw the Committee's attention to the independently delivered SME Finance Monitor, which is funded by the financial services industry.[1] This is one of the most authoritative source of

[1] https://www.bdrc-group.com/products/sme-finance-monitor/

data on the SME market, and is widely used by government, business groups, financial services providers and other industry bodies to understand how businesses are thinking of key financial issues and the business environment. We refer to its findings where relevant below.

We would be happy to discuss any of the points raised in our response further with the Committee.[2]

Management capability: How adequate is the availability of, and funding for, training courses aimed at SME managers? What more can be done to provide co-ordinated and high quality support to improve management capability throughout the UK?

UK Finance endorses the focus on building management capability and embedding best practice amongst SME managers, however we believe that other stakeholders, especially the business groups, will be well-placed to provide substantive input on this question. UK Finance fully supports the agenda pursued by this and previous governments to make the UK one of the easiest place in the world to start and run a business. Training, support and better sources of information and advice are all essential to improve the management capability that will allow UK SMEs to thrive.

We also encourage the Committee to refer to our comments on mentoring below when considering this question. Many small business owners often understand training and mentoring as the same – these artificial boundaries in the eyes of small businesses may prevent them getting to the right type of support and we should all work to help avoid misunderstandings around the valuable help available. For example, most training and support is informal, rather than delivered through formal training schemes.

Fair treatment: how effective are measures in place to protect small businesses against systematic late payment practices of large companies; are the powers of the Small Business Commissioner to police poor payment practices strong enough?

While progress has been made on this issue in recent years, in particular with the implementation of the Prompt Payment Code, administered by the Chartered Institute of Credit Management, this clearly remains an issue of concern for many businesses. As noted above, UK Finance would submit that the term 'late payment' is often used as a short-hand for a range of issues around poor payment practices.

UK Finance's regular Business Finance Roundtable (which brings together finance providers, business groups and government representatives) has repeatedly identified these issues as a source of concern for small businesses. While the most recent SME Finance Monitor report showed that the top three issues identified by business were legislation, regulation and red tape, the current economic climate and political uncertainty/government policy, cash flow and issues with payments, was rated a major obstacle by 8% of SMEs, well above the proportion citing access to finance as a concern.[3]

The UK's largest banks are all among the growing number of signatories to the Prompt Payment Code and the principles of the code continue to be embedded and gain even further recognition. That said, the recently appointed inaugural Small Business Commissioner, Paul Uppal, has a potential crucial and complementary role to play in addressing poor payment practices. The Committee may explore whether any additional powers would be beneficial.

While the Commissioner's role becomes established, UK Finance already believes there are some incremental improvements that could improve the position of small business. Many of these can often benefit from specialist types of lending such as invoice finance in managing cashflow, and greater awareness of the importance of managing cashflow could avoid issues arising later in a contractual relationship. Indeed, businesses should be encouraged to properly consider and where appropriate challenge payment terms at the outset of any relationship. Through education and signposting the Commissioner has a role in encouraging small businesses to get supplier/buyer relationships and contracts set-up on the right basis from

[2] The relevant policy leads can be contacted at: *commercialfinanceteam@ukfinance.org.uk*

[3] BDRC SME Finance Monitor Q2 2017(p. 255)

the start. The BEIS/Chartered Institute of Credit Management Managing Cashflow guides (https://www.cicm.com/resources/cashflow-guides/) are an excellent start, as is the ICAEW and British Business Bank's Business Finance Guide, which we were pleased to contribute to.[4]

Mr Uppal may choose to pursue more informal ('soft') intervention and guidance which could reduce the occasions that there is a need for more formal powers. With greater transparency of payment performance now required of larger businesses, a degree of public pressure and campaigning to influence behaviour should pay dividends.

UK Finance looks forward to working closely with Mr Uppal on this issue and a number of others, and we encourage the Committee to engage directly with the Commissioner, as well as providing his team sufficient time to evaluate what more can be done to address the issues of poor payment.

The Committee will also be aware that new Payment Practices Reporting Regulations came into force on 6 April 2017. This required large businesses to report their payment practices and performance every six months by providing prescribed information. As reporting begins across large businesses, we suggest that consideration on the effectiveness of this measure is made once the requirements have bedded in.

In terms of 'harder' interventions, UK Finance would draw the Select Committee's attention to the legislation expected to be shortly brought forward under the Small Business Act 2015 (Section 1). These Regulations nullify the effect of contractual clauses imposed on small suppliers by larger customers that prevent or make it harder and/or more expensive for the supplier businesses to access the full range of finance options and invoice finance in particular. The (currently titled) Business Contract Terms (Assignment of Receivables) Regulations 2018 are long awaited and will bring the law into line with best practice internationally, enabling UK small businesses to use what will often be their most significant asset – the debts owed to them by their customers – to access finance.

Once implemented it is essential that large company debtors comply with the spirit of the legislation. On this issue and more generally, the Small Business Commissioner should have a prominent public role in identifying and promoting good practice, as well as calling out bad. Tackling late payment would help increase business confidence across the supply chain and finance industry. The Groceries Code Adjudicator is an interesting example of a body that has been able to leverage a limited tool box of hard powers with a range of soft interventions to encourage behavioural change.

Improving productivity: what access do small businesses have to advice on improving efficiency and productivity through adoption of best business practices? What more should the Government do in this respect?

As noted above, UK Finance submits that the demonstration of best business practice, along with access to high quality training and education is key to UK businesses meeting their potential. Sir Charlie Mayfield's *Be The Business* initiative has garnered strong support across the business community and is being promoted by several finance companies to their clients.

Scale-Up: for those businesses wanting to scale-up, how effective is the promotion of available Government support? Do existing concessions for small businesses serve to discourage growth? What impact has the Scale-Up Task Force had so far?

Recent focus on scale-up businesses has been welcome (while recognising that many businesses do not, or would not wish to, meet this definition). Scale-Up businesses collectively have significant potential to the UK economy's growth going forward. As the ScaleUp Institute has noted, there is a 'huge prize' to be gained by supporting such businesses. According to Sherry Coutu CBE (its Chair), "a one per cent boost to our scale-up population would bring about an additional 238,000 jobs and £225bn in Gross Value Added (GVA)."

4 https://thebusinessfinanceguide.co.uk

As the voice of the financial services sector, UK Finance has an important role to play in the high-growth/patient capital finance debate. With BDRC, we are currently looking at how the SME Finance Monitor (discussed above) might better reflect the wider finance landscape for SMEs (including getting more data on scale-up businesses and businesses funded through alternative finance). A recent version of the SME Finance Monitor focused on the business perspectives of Scale-up businesses.[5] This highlighted some of the characterises of scale-up businesses (they are more likely to plan, trade internationally and innovate) and we would encourage the Committee to review this research.

The financial services sector welcomes the focus of the Committee on this important group of these businesses and the support Government can provide them. Since the Committee's 2017 inquiry into support for growing businesses, we have seen the publication of the Government's Industrial Strategy, alongside the Patient Capital Review. Focus must now be given to implementing the Scale-Up related initiatives within these important pieces of work. The ScaleUp Institute, which the industry supports through its Better Business Finance brand, is a natural source of expertise and co-ordination in taking forward the agenda.

It is now widely recognised that one of the important issues that Government and the private sector need to work together to address is the funding gap for high-growth business. At this stage, it is rarely traditional debt funding from high street banks that is the missing piece for these scale-up businesses. Rather, it is normally other forms of appropriate and patient capital, normally based on an equity source which these businesses need to have awareness of – and access to.

A number of UK banks are key investors in the BGF (Business Growth Fund) set up in 2010 with equity funding.[6] The Fund provides capital for growing firms as well as substantial educational and development support for talented directors and business owners looking to grow. Typical investments are in the range of £2m to £10m in equity and loan notes, normally up to 10 years in duration with the option for follow on funding. While it is a national fund, it has a network of regional offices and agents and strong links with local high street banking teams for referrals. The regional reach of the BGF is critical to the role it plays. 73% of the investments made have been in regions outside London and the South East, proving the point that there are high-growth high-potential firms across the UK. Member banks that are shareholders in the BGF remain committed to its work and look forward to a review of the role it can take in developing scale-up funding as part of a suite of appropriate funding mechanisms. Santander has a separate £200 million fund providing mezzanine funding to support high-growth SMEs. Barclays also has a £200 million Venture Debt fund specifically aimed at the high growth and entrepreneurial sector.

Despite this and a number of other developments, the estimated 'gap' in high-growth business equity investments is between £3bn and £6bn.[7] Solving this should be a national policy objective. UK Finance members welcome the Government's announcement in the Autumn Budget, of £2.5bn of new resources for the British Business Bank, which if this continues to be partnered with the private sector has the potential to unlock a multiple of this through co-investment. This will go some way to address the equity funding gap. We encourage the Committee to allow time to evaluate the potential impact this could have.

However, UK Finance would note concern about potential reduction in funds provided to businesses through the European Investment Fund which could exacerbate the problems discussed above. There are also additional sources of European Union funds upon which high-growth businesses currently can call the future of which is unclear. On this issue in particular, we continue to strongly encourage the Government to provide clarity on future membership of this fund, and if it is likely to be withdrawn, to address the gap this would leave.

Non-financial support

Alongside the supply of finance, there is still more to be done to support businesses' investment readiness. Access to authoritative advice and information is also key, and we would suggest that the impact of the so-called 'information gap' is at least important as the 'finance gap'. Much of this has a regional angle, whereby local ecosystems become self-perpetuating. Better integrated local networks, will foster more role models,

[5] http://www.scaleupinstitute.org.uk/sme-finance-monitor/
[6] See www.businessgrowthfund.co.uk; Barclays, Lloyds, RBS, HSBC and Standard Chartered invested £2.5bn into the fund. Santander has a separate fund delivering similar aims.
[7] Patient Capital Review, Industry Panel (page 6)

better business understanding and more businesses having peers and mentors that can support them on their growth journey. The establishment of British Business Bank regional managers should help somewhat in this – so long as they are complementary to existing sources information and are well connected into LEPs and Growth Hubs.

In addition to the comments above, UK Finance believes that a focus on mentoring as a source of influence and development for suitable firms could help with this. Many banks are playing their role in this ecosystem and we attach details of these for reference as appendix 1.

There is more to be done to ensure that mentors working with high growth firms have the right background and skills however, and the Government should seek to ensure that local ecosystems in particular are joined up. Whilst they tend to be variable (by definition) in terms of representation, funding and effectiveness, the potential role of the Local Enterprise Partnerships in facilitating this is key.

Cliff edge effects

Finally, we would bring to the Committee's attention a concern which has had less political focus with regards to Scale-Up businesses, that is cliff edge effects. While there has been appropriate focus on information, talent, leadership, sales, finance and infrastructure (all of which are important), there has been limited attention paid to cliff edge effects for such businesses whereby those that are still in high-growth phases may be caught by regulatory and taxation burdens that can seem excessive and disproportionate – and can often hit just at a critical stage of development. This includes financial services firms which are scaling-up and seeking to contribute to competition in the market in serving personal and business customers. We are currently working with the Scale-up Institute and others to assess what progressive steps can be taken to mitigate this potential barrier for firms.

Appendix 1 – Bank support for high-growth businesses.

Note that these are illustrative, and the actual support is much broader.

- **Barclays** has a number of programs providing businesses with support beyond financial services.
    - There are 14 Eagle Labs around the country providing access to expert networks and mentors for SMEs to help them with strategic business planning, translating their ideas into viable propositions and helping them to scale their business.
    - In addition, the Barclays Accelerator is an intense 13-week program designed to help new FinTech companies with mentoring, investment and opportunities to pitch their business to influential people in the technology community.
    - Finally, Barclays has created a dedicated team to support High Growth SMEs to ensure that their changing financial needs are met through the different stages of the company's growth. It has also linked up with the Cambridge Judge Business School to create a program dedicated to providing these Companies with the skills and knowledge they will need as they scale-up.
- **HSBC's** Entrepreneurs Exchange, which is business-led, aims to connect the next generation of British entrepreneurs with the UK's most successful business founders. Founders that have taken part in the events include: Anya Hindmarch CBE – Anya Hindmarch, Ray Kelvin CBE – Ted Baker, Craig Sams – Green & Blacks, and Holly Tucker – Not on the high street and Holly&Co. All companies which have expanded to various markets overseas, helping drive their success.
    - Attendees of these sessions have discovered how these established and successful entrepreneurs set up and grew their businesses, both in the UK and internationally, the challenges they overcame to enable success, and the advice they wish they had been given when starting out. The events are free and open to all, enabling attendees to build networks with other like-minded entrepreneurs in their region.
- **Lloyds Banking Group's** is the largest provider of mentors under the bank mentoring scheme within Mentorsme.
    - In addition, LDC, which was established in 1981 remains a leading player in the private equity mid-market and is able to provide up to £100m of funds for buyouts and development capital transactions in UK companies. It has supported 600 management teams, investing nearly £5billion of equity during this time.
- **RBS and Nat West** support their business customers in a range of ways from being the largest lender to SME businesses through to providing over one million financial health checks for SME customers in 2017 where we help our customers identify opportunities and risks in their businesses.
    - RBS also operates the world's largest free accelerator for start-up and scale-up businesses -a network of 12 entrepreneur support hubs which are 100% managed and run by the bank. Over the past three years, NatWest, Royal Bank and Ulster Bank have partnered with Entrepreneurial Spark to open hubs to support and connect start-ups and high-growth businesses across England, Scotland, Northern Ireland and Wales. This initiative has helped UK-based start-ups, reporting over £300 million in investment and more than 8,000 jobs created by the entrepreneurs, who benefit from the practical support and connections the UK-wide hub network offers. The hubs offer a comprehensive programme of free enablement, mentoring and bespoke coaching. We're committed to continuing this success, and through our UK-wide network of business accelerator hubs, we will support and continue to change the lives of entrepreneurs by providing full wrap-around care to the UK's most inspiring start-ups and high-growth businesses. During the last three years this programme has helped more than 4,000 businesses.

      The Acceleration programme runs from 6 to 18 months and is for entrepreneurs with high-growth businesses looking to scale up. It's designed to ensure they have the best chance of succeeding through providing free office space, wi-fi, business advice and mentoring, bespoke coaching, and access to our networks and supply chains.

The Pre-Acceleration programme is an intensive, 12-week course aimed at helping early stage start-up businesses to develop. The programme will run simultaneously in each of our hubs with entrepreneurs receiving a range of benefits from online learning materials to webinars. And because the Pre-Acceleration course is digitally based, it will be accessible to entrepreneurs who don't live near one of our hubs.

  - RBS announced in Feb 2018 that their Bristol, Edinburgh, London and Manchester hubs will become specialist FinTech accelerators. In addition to the offerings detailed above, up to 80 Fintech businesses will benefit from expert advice from computing firm Dell EMC. Entrepreneurs will also have the opportunity to pitch to the bank's Innovation Scouting Team and be introduced to key contacts at the Department for International Trade.
  - RBS/Nat West has also recently launched Esme Loans, an online platform for any business to log on and apply for an unsecured loan- from beginning the online application process to receiving funds in their bank accounts, successful applicants can get sometimes their loan in as little as an hour.

- **Santander's Growth Capital programme** which has seen it commit mezzanine funding to support high-growth SMEs that have advanced comfortably beyond start-up stage. In the past five years, Santander's Growth Capital team has committed nearly £500 million in new lending to more than 100 companies through this programme, helping to create more than 7,500 new jobs along the way. Growth Capital is debt finance, which means SME do not have to sacrifice control or significant equity in their business.
  - Like many banks, Santander have also created a wider network of support that goes well beyond pure finance. This support includes access to networking events, graduate internship schemes, and international trade missions. This is crucial in helping the businesses we back to achieve their full potential, often by making significant inroads into international markets.
  - Santander also offer several different programmes under their Breakthrough support, including Breakthrough International (a package of tools that takes a business through every step of international trade and export), one and two-day Masterclasses giving SMEs the unique opportunity to learn from some of the UK's market-leading companies and iconic brands.

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