Levelling up: Financing and capitalising the UK's SMEs – Session 4 Summary

13th July 9:30am - 10:30am

Session 4: Regional and sectoral availability of SME finance

APPG inquiry panel:

- Kevin Hollinrake MP, Conservative
- Lord Holmes, Conservative
- Peter Dowd MP, Labour
- Lord Sharkey, Liberal Democrat
- Sarah Olney MP, Liberal Democrat
- Alison Thewliss MP, SNP
- Tonia Antoniazzi MP, Labour (could not attend fourth session)
- Ben Lake MP, Plaid Cymru

Regional availability of SME finance witnesses - 9.30 - 10.10am:

- Richard Jeffery, National Director, GC Business at The Growth Company
- Professor Colin Mayer CBE FBA, Saïd Business School, Oxford University

Sectoral availability of SME finance witnesses 10.10 - 10.30am:

- Jessica Levy, Director of Communications at the Federation of Master Builders
- David Sheen, Public Affairs Director of UK Hospitality

Key themes:

- Equity finance is largely concentrated in the Southeast, encouraging firms to move to the area, increasing regional disparities and taking opportunities and jobs away from other areas.
- SMEs find it difficult to understand and obtain financing, increasing the need for local branches to provide advice as well as establishing a position within the community to build relationships, understand firms, their individuals, and the local economy to effectively assess loan eligibility.
- Getting local ecosystems to work more collaboratively will allow authorities to work with banks, local firms and universities to effectively understand how best to distribute financing to areas that need it most.
- Access to finance isn't the number one issue facing small businesses according to their member bodies, but ranks highly and especially in the construction industry many small businesses are being rejected despite long standing relationships with high street banks.

A full summary of the inquiry is below

Panel 1

From your experience, do SMEs in your region have difficulty in accessing the right financing and support for their business to grow or adapt? How do you feel this compares to other areas of the UK? (Peter Dowd MP)

- Colin Mayer (C.M) said SMEs definitely have difficulties in accessing the right financing and this comes down to three main reasons.
    1. While banks are distributed across the country in proportion to companies, provision of funding outside of the South-East is focused on short-term funding such as overdrafts and credit cards. Due to bad experiences with challenger banks, SMEs continue to turn to highstreet banks, further increasing their share of the market.
    2. Due to the large concentration of equity finance in London, there is a serious problem for companies seeking to start up and grow in other parts of the country.
    3. Firms are generally assessed by lenders using information from balance sheets and information about the firm. The local context is important and this emphasises the need for SMEs to have local branches with a degree of authority to understand local communities, something that large banks now lack.
- Richard Jeffery (R.J) supported C.M's claim that SMEs have difficulty in accessing the right finance but said access to finance is not necessarily the main challenge, instead access to the market and adapting business models to economy-wide changes is becoming increasingly significant. R.J found the recent injection of cash into the market has presented two challenges around financing for SMEs. The first being awareness barriers for SMEs around financing options, namely, finding the best financing options for their needs and how to present themselves in the best way. The second issue is the lack of local ecosystems working cooperatively. It is important for localities to get banks and local authorities to cooperate in order to get financing to all areas in need. Therefore, R.J argued that there is a need to build on improvements already made in the market instead of starting from scratch. An example is the Growth Company Angels in Manchester, bringing together investors to share risks, which has currently provided 58 rounds of funding.

In other countries, such as the USA, there are regional and community lenders who offer specialist knowledge of the local area and can lend to hard-to-reach groups, often with a more hands on approach than traditional banks. Do you see any benefits of more regionally focused financing options and would having our own version of the US Riegle Community Development and Regulatory Improvement Act of 1994 be a viable option? (Lord Sharkey)

- C.M finds the international comparisons 'striking' and thinks regional banking in the UK, by comparison, could be much better. C.M continued R.J's point about building on existing improvements by drawing attention to Handelsbanken, the decentralised Swedish bank that gives decision-making powers to local branches. As a result, they became the fastest growing bank in the UK and didn't need bailing out during the Financial Crisis. This demonstrates that even with a large international bank, it is possible to replicate the features of local banking, creating longer-term banking. In terms of government policy, C.M observed that while recently there has been large provision of finance by the government, there needs to be more focus on ensuring it is channelled effectively across the country, especially to help start-ups, an area that has a lot of room for improvement when compared to countries like the US.

- R.J said the UK has some great institutions like the British Business Bank (BBB) that has created initiatives like the Northern Powerhouse Investment Fund (NPIF) in an attempt to reduce regional disparities, however this could be further improved by focusing on local ecosystems to provide greater scope.

Is there a role for the Government to play in addressing regional disparities? What other institutions, private or public, have a part to play? (Alison Thewliss MP)

- C.M was of the opinion that the government has a vital role to play, especially in encouraging the partnership between local businesses, local professional firms and local universities to encourage the distribution of finance. C.M said the UK Infrastructure Bank seems promising and has the opportunity to play a large role in this area. With regional authorities having more of an influence in the financial market, there is potential to think imaginatively to increase the availability of funds, potentially using a share of corporation tax or VAT to provide funding at local levels. In relation to the private sector, they play an important role in getting the right funding provision at scale to flow into different regions.

The Scottish National Investment Bank is looking at investing into projects by businesses seeking more than £1million of investment support. Do you think there is a need for investment below the £1million barrier? (Alison Thewliss MP)

- C.M thought there definitely is a need for investment below that mark as getting companies across the £1million mark is a barrier, but business angels are a really promising solution. Not only do they provide financial support but they have the knowledge base of someone who has been successful in building a business.
- R.J agreed with C.M that it is not just about financing but about the advice and guidance provided by business Angels. Mentoring provided can bring start-ups along as the market grows. Often, making more funding available for co-investment brings individuals together to make an initial investment, kick-starting the process.

What are the wider economic consequences of limitations of access to finance for SMEs in your area, thinking in terms of economic recovery, innovation and productivity? (Lord Holmes)

- R.J argued that the greatest consequence is missed opportunities. Often businesses move to the South East, taking jobs and opportunities out of other areas. However, recent changes to build local ecosystems have broken this chain and began to attract individuals and firms to areas outside of the South East. R.J also emphasised the importance of tackling other disparities that remain prominent issues, such as difficulty in accessing financing for minority-led businesses as demand continues to outweigh supply in this area. R.J, if he was able to ask the Government to do one thing in this area, would be asking for increasing funding availability for co-angels and backing up support of existing funds.

- C.M said a large consequence is that the UK has one of the highest regional disparities across Europe. It is increasingly common for firms to move to London or even the US in order to access financing at scale, further worsening regional disparities.

Panel 2

From your experience, do SMEs in your sector have difficulty in accessing the right financing and support for their business to grow or adapt? (Ben Lake MP)

- Jessica Levy (J.L) said there is significant difficulty in accessing finance in the UK construction sector. A survey run by the Federation of Master Builders (FMB) over the last ten years has shown that access to finance has consistently ranked in the top three problems faced in this sector.
- David Sheen (D.S) said that the UK hospitality industry has similar difficulties, plus current issues are largely due to the pandemic. He described CBILS and BBLs as positive stories coming out of the pandemic. Outside of the pandemic, access to finance is not necessarily a huge issue but an item of concern that has consistently been raised over the years.

Are there any patterns emerging in types of businesses within your sector finding it easier? (Ben Lake MP)

- D.S notes UKHospitality are hearing reports of hotels struggling with financing as well as pubs and restaurants at this time.
- J.L explained that in the last year, no members of the FMB were accepted for CBILS, however the introduction of BBLS saw an increase in acceptance rates. J.L questioned whether this was due to the scale of the businesses FMB represents. The current most prominent issue facing firms in construction is access to materials due to a global shortage with access to labour and access to finance being the second and third most prominent issues. In terms of patterns emerging, J.L said that firms in the upper end of the SME sizing scale are beginning to be in considerable financial difficulty following the pandemic due to the larger supply chain that they find themselves in, smaller firms are struggling to make payments on time causing these firms to struggle to pay firms above them.

What are the wider consequences of any limitations on access to finance for SMEs in your sector, particularly as your sector recovers from the pandemic? (Sarah Olney MP)

- J.L explained construction is susceptible to financial down-turns. 40 years ago, 40% of houses were built by SMEs with that figure now at 12%. Every financial crisis causes SMEs to fall and not be able to return to the market. J.L expressed her worry that some members are only a couple months away from not continuing, especially due to a lack of materials. More long-term consequences include businesses in this frail state causing more SMEs to go under quicker which will have further impacts on skills and labour training, especially as most apprentice training in this sector is done by SMEs. Another consequence, and arguably a very significant one, is the ability to reach net zero targets. Retrofitting is likely to be done by

SMEs but with increasing difficulty in accessing materials and finance, it is questionable whether SMEs will be able to complete such a task.

- D.S said access to finance in the hospitality sector is critical due to cyclical investment patterns. If there isn't finance to invest in highstreets, business will simply go under and the positive impact hospitality has on the wider community will be lost. Hospitality tends to be a lot of individuals' first job, if those jobs don't exist then the 'first rung on the ladder is removed'.

Why do you think commercial banks aren't interested in lending to your sector? (Kevin Hollinrake MP)

- J.L pointed out that almost half of FMB's members receive financing from high street banks due to long-standing relationships. Despite these relationships, there are increasing rejections for firms in construction as banks begin to find that these firms are 'not worth the while'. A recent survey showed one of the biggest difficulties facing firms in construction accessing finance was the loan to asset ratio decreasing from 65% to 50% and fees charged on loans increasing.

The impression I got from R.J is that there seems to be sufficient cash available and a number of people have said it's about the coordination of getting access, they just need the information available. I'm not sure that Jessica is saying that, rather that it's difficult to actually get the cash. Is this where the confusion comes in and what is causing the problem? (Peter Dowd MP)

- J.L agreed with Peter Dowd's point completely saying FMB have worked with UK Finance to open up the market to members through education. This sector's struggle for finance doesn't necessarily mean there isn't money but suggests that firms aren't going to the right places. J.L adds that construction firms with long-lasting relationships with banks find it surprising to be rejected and often have to look for alternative financing with a lot of time pressure and a lack of knowledge and confidence.

Useful documents

- The British Business Bank - The UK Business Angel Market 2020
- UK Finance - Understanding SME Finance and Regional Difference
- Oxford Review of Economic Policy by Paul Collier and Colin Mayer - Reforming the UK financial system to promote regional development in post-COVID Britain

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