Department for Business Innovation & Skills

HM TREASURY

BOOSTING FINANCE OPTIONS FOR BUSINESS

Government response to the industry taskforce

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Introduction

1. The Government is committed to ensuring that UK entrepreneurs and businesses are able to access the finance they need to grow. Creating an environment where businesses can access the right finance at the right time can bring benefits for jobs and for growth. Bank lending will remain a crucial source of funds, but many businesses have become very reliant on banks for their financing needs. The future finance environment needs to be more diverse with Government and the finance community supporting the needs of UK businesses.

2. That is why the Government asked Tim Breedon to chair an independent industry taskforce to examine structural and behavioural barriers to alternative debt markets in the UK. This is an important subject and the Government invited evidence-based recommendations on practical measures to facilitate the development of these markets.

3. The Government welcomes the taskforce's report and agrees that more can, and should, be done to build alternative markets and unlock new pools of capital. The taskforce's report recommends areas where industry can act to stimulate and expand alternative finance markets and where there are actions for Government to take. The Government agrees with the analysis set out in the report, welcomes the commitment shown by those named in the report in taking forward the recommendations, and commits to work with businesses and the broader finance community to address these important objectives.

Increasing awareness and demand for alternative sources of finance

4. **The Government welcomes the market-led solution being developed** by ICAEW, ICAS and ACCA **to create a credible new brand for Business Finance Advice** by January 2013. Evidence shows that businesses who seek external financial advice tend to display improved performance. Government believes the Business Finance Advice scheme can give businesses the confidence to seek advice, and encourages the business community to support this initiative.

5. Government is also committed to playing its part. Free advice and guidance on the options for financing business growth is already available through the online Business Link portal[1], which now includes the Business Finance Finder tool. Government recognises that more could be done to improve the communication of existing government support on access to finance for SMEs. **The Government will consider how best to improve both awareness and understanding of SME schemes**, reporting back later this year**.** This will include consideration of existing schemes and the use of a unifying umbrella brand to provide more clarity to SMEs.

6. The Government also welcomes the suggestion of a single delivery agency for Government support schemes. This provides a welcome contribution to the debate on the role of Government finance interventions in tackling market failures. The comparison with state-supported agencies in other countries shows the different models available. **The Government will examine the options and will need to consider the evidence and rationale carefully, balancing any proposals for change with the need to ensure continuity for existing schemes that work well**, reporting back later this year.

Improving access to capital markets financing for UK companies

7. The Government agrees it is desirable to harness the depth and sophistication of UK capital markets to serve better the needs of smaller businesses.

[1] http://www.improve.businesslink.gov.uk/finance

8. For SMEs, the Government recognises the positive role aggregation could play in enabling institutional investors to invest in SMEs. **The Government welcomes and will support the feasibility study into how such aggregation models could be developed,** involving participants from across the finance community and co-coordinated by the Association for Financial Markets in Europe. The Government recognises it may have a role to play in supporting the initial development of these markets. If such support is appropriate, the Business Finance Partnership (BFP) could be a potential source. However, it will be important to ensure that BFP investments are commercially sustainable and require private investors to share in the risks that taxpayers would potentially be exposed to.

9. Separately, the UK financial authorities will be publishing a paper later this year on improvements to UK securitisation markets, which are another potential tool for directing institutional investment to SMEs.

10. For mid-sized businesses, **the Government welcomes industry ambitions to expand the UK private placements market**. We are grateful to the Association of Corporate Treasurers (ACT), which has agreed to drive and co-ordinate this through the establishment of a UK Private Placements organisation to standardise documentation and develop common processes for credit appraisal.

11. The taskforce also discusses how to increase UK retail investor appetite for, and access to, UK corporate bonds. The Government welcomes the recent growth in retail bond markets and supports proportionate regulation of these markets, balancing the needs and protection of investors against the regulatory burden on issuers and the markets themselves. An example of this is the Government's support for forthcoming amendments to the EU Prospectus Directive, to be introduced in July 2012, which will establish a proportionate disclosure regime for public offerings made by SMEs and companies with reduced market capitalisation.

12. The taskforce suggest that one way of improving retail investors' familiarity with bonds could be through launching retail-dedicated gilt products on registered exchanges.

13. At present retail investment in Government borrowing is delivered primarily through National Savings and Investments, whilst gilt products are issued by the Debt Management Office (DMO) and mainly focused on the wholesale market. Both these institutions have a mandate to finance Government borrowing at the lowest possible cost to the taxpayer, subject to risk. The DMO keeps its issuance channels under review and would consider using emerging retail bond platforms if they were to provide a cost-effective proposition. Retail investors can already invest in gilts by applying directly at one of the DMO's public auctions, and can also invest in the secondary market through its Approved Group and Purchase and Sale Services, through a bank, a stockbroker of their choice, or the DMO's approved market makers.

14. For investment in smaller companies or funds, the taskforce discusses a number of changes to Individual Savings Accounts (ISAs) to incentivise retail investment. The Government is not minded to amend the ISA scheme. ISAs are a successful and popular product - around 45% of the adult population currently holds one – and their relative simplicity and the coherence of the brand are important to that success. ISAs already offer generous reliefs allowing people to invest up to £10,680 each year in a "stocks and shares" ISA without incurring tax on their returns. The range of qualifying investments includes securities issued by companies listed on a Recognised Stock Exchange: this may include companies of a range of sizes. There is also scope for UCITS, NURS and other investment funds that qualify for inclusion in an ISA to invest part of their funds in smaller, unlisted companies. The Government considers that this provides the right balance of risk given the nature of an ISA investment. The proposed changes would complicate the scheme and undermine its core purpose of providing a relatively simple, safe vehicle which encourages people to save.

Larger companies stimulating growth through supporting smaller companies

15. The taskforce has made a number of recommendations to encourage and drive prompt payment through the supply chain. The Government believes that all firms should be able to manage their supply chains in a way that suits them, but that larger firms should not benefit by squeezing terms offered to smaller suppliers. **The Government already acts as an exemplar on prompt payment, with a target to pay 80% of undisputed invoices within 5 days and requires its prime contractors to pay Tier 2 suppliers within 30 days.** The Crown Representatives team, who coordinate the Government's approach to the management of key suppliers across all departments, strongly encourage prime contractors to pay more quickly than 30 days.

16. Departments monitor the performance of their suppliers in meeting the 30 day commitment and are expected to follow up instances of consistent poor performance as part of their contract management processes. In addition, suppliers can use the Cabinet Office's 'Mystery Shopper' service[2] to report to Government instances where payment is slipping, as well as other instances of poor procurement practice. The results of Mystery Shopper cases are published quarterly.

[2] http://www.cabinetoffice.gov.uk/content/cabinet-office-mystery-shopper-scheme

17. Beyond prompt payment, the taskforce recommend that larger companies use their credit strength to help suppliers access additional sources of credit and improve liquidity levels. **The Government is keen to examine the role of innovative solutions, such as supply chain finance, which aim to speed up payments within supply chains, and will seek out opportunities to bring businesses together to explain and promote its potential as a credible financing option**.

18. The Government is also exploring:

- **how to speed up payments to SMEs in its own supply chains**
  The Government has recently announced plans to extend the use of Project Bank Accounts (PBAs) beyond the Construction Sector across government procurement, commencing with Facilities Management and Defence. PBAs have been successfully piloted by the Highways Agency and have had significant success in reducing the duration that tier 2 suppliers have to wait in order to get paid. In addition, the Government is also considering the role of supply chain finance as a means to reduce the working capital costs for the SMEs in its supply chains;

- **whether Government can use its purchasing power to encourage greater use of supply chain finance for businesses;**

- **the role for supply chain credit support to enable faster payments** within supply chains more generally; and

- **whether Government guarantees can be used to support supply chains**, including the scope for UK Export Finance, businesses and banks to work together.

Developing new financial products

19. The taskforce highlights the potential growth in emerging financial products, including asset-based finance, mezzanine finance, and peer-to-peer lending as alternatives to traditional bank finance. It calls on Government to stimulate further development of these products by inviting bids to the Business Finance Partnership (BFP).

20. The BFP has initially focused on investment in loan funds that can lend directly to mid-sized businesses. The Government requested proposals for investment in January 2012, and 24 were received. Budget 2012 announced that the Government intends to invest up to £700m with some or all of seven shortlisted fund managers, subject to due diligence and private sector fund-raising. The Government also allocated an additional £200m to the BFP.

21. **The Government** has also considered other channels through which the BFP could invest, and **supports the aim to use the Business Finance Partnership to stimulate innovative and sustainable forms of finance that can reach smaller businesses**. The Government welcomes the development of new and innovative forms of finance such as peer-to-peer lending and recognises the potential of these models to have a positive impact on the SME lending market. **The Government has allocated £100m of the BFP to invest through non-traditional channels that can reach smaller businesses, which could include peer-to-peer lending as well as mezzanine loans and asset-based finance.** The Government will request proposals for investment in May. The Government also welcomes moves by peer-to-peer lending platforms to develop an industry body, which could help raise awareness among SMEs and investors and establish industry standards to protect investors and borrowers.

22. The Government recognises the important role played by Community Development Finance Institutions (CDFIs) in providing loans to smaller businesses. These constitute an important part of the business finance landscape and can present a genuine alternative to mainstream lenders. The Government supports investment into CDFIs through the Community Investment Tax Relief (CITR).

23. Beyond specific products or institutions, the taskforce also pointed to the potential for greater sharing of information to facilitate more lending via non-bank channels. This issue has frequently been raised as a potential barrier to the development of alternative sources of debt finance. **The Government agrees that this warrants further exploration and would welcome a commitment, through the British Bankers' Association (BBA) working with non-banks and credit reference agencies, to improve the sharing arrangements for credit information in order to facilitate greater accuracy in the assessment of risk.**

24. **The Government** has already committed to opening up public data in the interests of greater transparency and **will explore whether the release of further specific types or categories of data, be it publically or for individual use, would be of benefit** to third party assessors of risk thereby facilitating the provision of finance - whether formal such as a loan or informal such as suppliers offering extended credit.

The evolving regulatory environment

25. The Government believes the current balance of regulation is appropriate and will strengthen the resilience of the UK financial sector, thereby supporting the wider economy. Analysis by the Basel Committee on Banking Supervision[3] and the European Commission[4] suggests that there will be large net benefits to the UK

[3] http://www.bis.org/publ/bcbs173.htm

[4] http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm

economy of the Basel III agreement, with SMEs as key beneficiaries of enhanced macroeconomic and financial stability.

26. While the macroeconomic benefits of these regulations are clear, the Government is also committed to ensure that any unintended consequences that disadvantage businesses are considered. The UK financial authorities are supporting an evidence-based approach at the European level to help ensure consistency across European rules. For example, the draft Capital Requirements Regulation and Directive IV tasks the European Banking Authority (EBA) with a study into SME risk weights. **The Government would welcome any discussion which would contribute to this work and evidence base.**

27. Another relevant issue the taskforce raise is the treatment of trade finance under Basel III. **The Government welcomes the ongoing efforts of the BBA's Business Finance Taskforce in analysing this matter and encourages them to develop further evidence.**

28. On Solvency II, the Government remains committed to working with the industry to ensure a sensible package to protect insurers' role as investors in the economy, for example on long-term guarantee products.

29. The Government recognises the importance of continuing engagement in the European debate on financial regulation and already works closely with the Bank of England and the Financial Services Authority to gather evidence on these issues. The Government would welcome ongoing engagement from industry to ensure that international regulation is proportionate and balanced in its impact on SMEs.

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