Dr Vince Cable
Department of Business Innovation & Skills
1 Victoria Street
London SW1H 0ET

24 June 2013

Dear Secretary of State,

Ref: Business Bank Advisory Group Recommendations

You asked us to provide you with advice on how to establish a British Business Bank. Following our deliberations, we fully endorse your objective to set up such an institution and urge you to implement your plans as quickly as is practicable.

We agree with your assessment that there are a number of structural and cyclical problems which choke off finance to parts of the small business population. These range from changes in the lending behaviour of the major banks to long-standing shortcomings in the early stage venture capital market and are exacerbated by the relatively concentrated UK commercial banking market. Further analysis is set out in the background document annexed to this paper, which we believe leads to the conclusions that the Business Bank should:

- support the development of diverse debt and equity finance markets for SME and mid-cap businesses;
- promote competition and increased supply through new finance providers;
- and increase the provision of finance to viable but underserved SME and mid-cap businesses.

Not tackling these issues will impact the economic prospects of the UK. There are clearly many UK small firms which are world leaders in their sectors. However, the blunt truth is that our SMEs invest less in skills, invest less in capital equipment and export less than their peers in our main international competitors. There are numerous reasons for this, but we believe that a major part of the explanation must be that our finance markets do not work as well as they ought. In order to tackle this problem strategically, our **first recommendation** is that **the Business Bank should bring together the management of ALL the Government's existing business finance schemes, evaluate them and rationalise them**. This will ensure that interventions are coherent, systematically organised and easy to communicate to the business community. Any interventions must build on what has been shown to work.

Given the importance of the task, we urge you to work pragmatically but at pace. We looked at the question of whether the Business Bank should also be the home for the myriad range of finance advice and other business support activities funded by the public sector, as these are also designed to raise firms' economic competitiveness. We support immediate reorganisation and rationalisation of such programmes, but **our second recommendation is that consolidation of**

business advice programmes initially should be a separate project to the establishment of the Business Bank in order to ensure that sufficient focus is attached to each initiative. However, we also recommend that **as soon as is practicable**, finance advice is brought under the umbrella of the Business Bank.

The Business Bank will need to be responsive to the needs of the UK economy and Ministers will ultimately be accountable for the Business Bank's strategic objectives. But we do not think it appropriate for operational decisions to be influenced by political considerations. This is why we believe the Business Bank should not be an executive agency nor a Government Department. **Our third recommendation is that it be set up** as a company under the Companies Act 2006, with a public sector shareholder as the sole shareholder.

Ownership structures alone will not mean that businesses and the public will have faith that the Business Bank is operating in their interests. In order to allow such confidence to be built up our **fourth recommendation is that the Business Banks' performance measures are expressed as quantified financial targets and that progress against these targets is reported transparently**. These measures should cover:

- the impact on the availability of total SME lending/investment as a result of Business Bank activity (including its leveraging of private sector funds)
- within this, the specific impact on additional lending/investment provided by small bank or non-bank lenders that have received support from the Business Bank
- a target rate of return on the Government's investment in the Business Bank, equal to the Government's social rate of return.

In order to move at speed, the Advisory Group feels that it is essential that you build on infrastructure that already exists. Most of the current business finance programmes are delivered in a highly professional manner by Capital for Enterprise Ltd, a company set up and owned by Government for this purpose and based in Sheffield. Capital for Enterprise is a more limited organisation than the Business Bank is intended to be: its operating freedoms are narrowly prescribed and it does not have any of the Government's assets or liabilities on its own balance sheet. A good foundation exists upon which you should build. **Our fifth recommendation is that the full delivery capability of Capital for Enterprise Limited should be retained within the new Business Bank and that therefore the Business Bank' headquarters should be in Sheffield, reflecting how critical it is that this be a regionally based organisation**.

The Advisory Group has assessed the Government's current interventions to improve business finance markets. The public sector now has hundreds of millions of pounds worth of investments in early stage venture capital and debt funds for UK companies, and has made recent commitments to increase this significantly through a combination of a number of initiatives from BIS and HMT.

These interventions seem to address significant gaps in commercial markets – for example – the Enterprise Capital Funds, which support early stage venture capital seem to draw in private sector capital to the market without putting the taxpayers' money at unnecessary risk. The Government is also using guarantees to boost prudent lending. The Enterprise Finance Guarantee is a programme that generates upward of £300m of additional lending in the economy every year. Recent innovations such as extending the programme to non-bank suppliers of credit, such as Kingfisher/B&Q seem sensible and innovative. The Advisory Group supports the recently launched Business Bank Investment Programme and understands that it will build on previous similar programmes such as the Business Finance Partnership. In these programmes, Government invests money alongside private sector providers of finance on equal terms, thereby generating more funding to SMEs from new and innovative market entrants, whilst sharing both risks and rewards. Reducing the Government's contribution to less than half would be a sensible move to increase the multiplier effect.

Where existing initiatives can fall down is when they are sub-scale, poorly marketed or – in one or two cases – poorly integrated in lenders' processes. The Business Bank needs the freedom to be able to design and implement interventions on the basis of its understanding of the market and how it works. **Our sixth recommendation is that the Business Bank should have the freedom to allocate resources to what it considers will be successful interventions and that it should be free from any political pressure both to launch suboptimal interventions or keep them going**.

The quid pro quo of these freedoms is **our seventh recommendation that the Business Bank requires excellent financial and risk management systems** to act as an effective steward of public funds. This culture of prudence should not drive out innovation – many of the Government's most promising access to finance interventions are recent and imaginative variants of older programmes. It must also be self-financing in the medium-term. However, new interventions should be tested carefully before being rolled out. Consideration should also be given to how SMEs access funding. We think it is sensible that the Business Bank initiative does not overturn the principle that SMEs should not apply for loans or investment directly from the Government. Instead funding should continue to be distributed through intermediaries such as the banks, funds and peer-to-peer platforms. **Our eighth recommendation is that the Business Bank should only create new interventions on the basis of evidence of economic need and once its research has established there are credible delivery channels.** Until such research has been done, we recommend that there is little point in creating capacity before it is required. We see no reason why it should consider wholesale activities.

Next steps

Our overriding message is that the Business Bank needs to be fully operational as quickly as possible. We understand the formidable organisational and regulatory channels in setting up a new institution. The Advisory Group understands that there are some constraints, such as assuring the European Commission that the Business Bank is compliant with EU state aid rules and that this can take time.

Our final recommendation is to put the leadership of this important new national institution in place urgently starting with the **immediate recruitment of a chairman to lead this important new institution** supported by an **interim CEO and leadership team.** The leadership team should be charged with supporting the Chair and doing all that is possible to operate as a virtual Business Bank initially within ministerial control pending the receipt of EU approval, so that money flows to UK firms as soon as possible.

We recommend that one or two members of the Advisory Group be involved in appointing the Chair. We also recommend that the Investment Committee for the new Investment Programme should include a representative of Capital for Enterprise Limited to ensure consistency with existing programmes.

Yours sincerely

Peter Burt.

Brendan Barber.

Sir Peter Burt (Chair)
Lucy Armstrong
Sir Brendan Barber
Caroline Green
Stephen Welton
Baroness Wheatcroft