HM TREASURY

BIS
Department for Business Innovation & Skills

# Financing business growth:

## The Government's response to *Financing a private sector recovery*

October 2010

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# Executive summary

Ensuring that viable businesses have access to suitable and diverse sources of finance is crucial for delivering sustainable economy recovery. Without this, innovative new products will stall at the stage where they are just a 'good idea', businesses that want to borrow and invest will not have the capacity to do so, costing new jobs and holding back firms that have an ambition to grow.

The Government is dedicated to creating the conditions for strong, sustainable growth, by ensuring the UK has competitive, dynamic and efficient markets that provide the right support to business.

That is why the Government asked wide ranging questions about the current access to finance landscape and ways to improve this in its consultation '*Financing a Private Sector Recovery*'. Of the 183 responses the Government received, the predominant focus was on the problems faced by small businesses in accessing both the debt and equity markets. Other areas of focus were on assisting small business to become more investment ready, the availability of trade finance and rebuilding business/ bank relationships.

Small businesses have a crucial role to play in creating employment and strengthening competition. At the start of 2009, small businesses in the UK accounted for almost 60 per cent of private sector employment and 49 per cent of private sector turnover. The last 15 years has seen a large increase in the number of small businesses in the UK, but these have tended not to grow. Two thirds of small businesses have an aspiration to grow but only about one-fifth achieve that goal.

There were also real concerns highlighted around: the impact of instability in the financial markets on business' ability to access finance; the lack of a competitive and transparent banking system; and the relatively narrow range of products available to some businesses.

The Government has therefore developed a comprehensive package of measures to respond to all of these challenges and welcomes the Bank Taskforce commitments as an important contribution to improving the lending environment. The private sector is also responding to provide a diverse range of finance options for businesses, a development which is welcomed by Government.

**Chapter 1** responds to the problems that were highlighted around a lack of competition in the banking sector, instability in the financial system and limited access to debt capital markets outside the UK's largest corporates. It also reflects respondents' need for a simple, stable and competitive tax regime.

The Government is taking action to address these issues by establishing the Independent Commission on Banking, which is considering the future of the banking industry, including the extent to which large banks distort competition by being perceived as 'too big to fail'. The Office of Fair Trading is reviewing the barriers to entry, expansion and exit in retail banking, covering both personal and SME banking. The Government will also actively support the industry in taking further steps to promote the development of corporate debt capital markets.

**Chapter 2** delivers a comprehensive package of support, both Government and industry-led, to answer the concerns raised by the small business community in the following areas:

- expanding the range of support available for SMEs, including alternative sources of finance;

- extending existing schemes that provide finance for viable small businesses; and
- helping banks and businesses work together more effectively.

# Expanding the range of support available for SMEs

## Support for early stage and growing SMEs with highest growth potential

**The Government will continue the programme of Enterprise Capital Funds**, increasing its commitment by £200 million over the next four years, providing more than £300 million of investment into the equity gap for early stage innovative SMEs with the highest growth potential after taking private sector contributions into account.

**The Government will encourage Business Angel groups and the Government's SME investment arm – Capital for Enterprise Ltd - to put together a bid to the Regional Growth Fund for a Business Angel co-investment fund**. If successful, this will support Angel investments into high growth potential early stage SMEs, particularly in areas worst affected by public spending cuts. The Government believes that this is the kind of activity that would be well placed to take advantage of the Regional Growth Fund application process.

Seven major UK banks, working through the British Bankers' Association (BBA) to form the Business Finance Taskforce, are also supporting the provision of equity finance to small and mid-sized businesses, through **a new £1.5 billion Business Growth Fund**. This will provide flexible equity finance for established businesses with growth potential seeking around £2 million to £10 million, focusing on businesses with an annual turnover of £10 million to £100 million. The Government will work with the banks to ensure the success and efficient delivery of this scheme and will work with other parties, such as the European Investment Fund, to potentially increase the scale of this.

These various forms of equity finance will make available up to £2 billion in additional equity financing for SMEs.  This could allow these firms to strengthen their balance sheets, against which they should be able to raise a significantly greater amount of bank debt. It is possible that this could help raise as much as £2 in loans for every £1 of equity investment in some cases.

## Support for SME lending

**As part of ensuring that viable SMEs with no financial track record or insufficient security can access debt finance, the Government will continue the Enterprise Finance Guarantee until 2014-15,** providing up to £600m of additional lending to around 6,000 next year alone and, subject to demand, over £2 billion in total over the next 4 years.

**The Government will work with large corporates to increase the provision of supply chain financing (SCF).** The Government is keen to ensure that access to local sources of finance for small businesses is expanded and will explore the scope for supply chain financing solutions at a local government level, building on the success of public sector examples.

## Support for exporters

The Government will work with the BBA to explore the scope for **a commercial scheme based on the successful Enterprise Finance Guarantee for businesses seeking working capital to fund exports.**

**The Government will also consider how an Export Credit Guarantee Department bond support scheme for exporters might operate** and is discussing this with the BBA and exporter groups.

## Helping banks and businesses to work together

Specialist advice to help businesses prepare for external investment can significantly improve the chances of accessing appropriate finance. To support SMEs with high growth potential, the Government will be establishing a **network of 'growth hubs' to provide this strategic advice and coaching to SMEs**. The **BBA is also funding and implementing a national network of business mentors**, supporting Government action in this area, and working with other organisations such as the Federation of Small Businesses and the Prince's Trust.

The UK needs a competitive and transparent banking system with clear standards. To improve the relationship between banks and business customers, the Government has worked with the BBA and business representative bodies to set out the key areas where small firms feel let down by their banks. As a result, the **banks' Taskforce has undertaken to revise the lending code and lending principles** for small businesses and create a new internal appeals process for declined applications. The Government will also encourage the BBA to disclose more public data around this appeals process, to increase business confidence that this is working. **The Government will maintain the pressure on the banks to deliver these commitments and will hold them to account on a monthly basis to ensure rapid progress is made**

The Government looks forward to continuing its dialogue with businesses and investors on these proposals, to ensure the conditions are in place for financing strong future growth. The **Small Business Economic Forum,** bringing together government, business representative bodies and the investment community and meeting quarterly, will scrutinise the implementation of the commitments the banks have recently made, their pace and impact.

## Next Steps

The serious under-capitalisation of British small businesses, especially compared to their counterparts in the US, both in the start-up stages and subsequently, needs to be addressed. This is the start of the process of getting access to finance for SMEs back on track, though this is not the end of the story on finance issues and the Government is not complacent. The Government will not stand by and let the businesses of tomorrow fail on the basis that they can't attract investment and will drive progress on the actions that the Banks have committed to through the Business Finance Taskforce and continually monitor the operation of Government schemes to help SMEs access finance.

The Government wants to make the UK the most attractive developed economy in the world for investment in SMEs and will review the international competitive landscape in time for Budget 2011.

# 1 Ensuring stable financial conditions for all business

1.1 As noted in the Government's Green Paper "*Financing a Private Sector Recovery*", financial conditions have improved since the beginning of the crisis and recovery is now under way, with the economy registering its fourth consecutive quarter of growth. However, the Government is not complacent and recognises that there are risks to the future provision of credit to businesses as the demand for loans picks up, as well as a need to reform the tax and regulatory systems to provide the confidence needed by businesses to invest and improve financial stability in future.

1.2 There was broad agreement amongst respondents that a stable financial environment is key to business growth and investment, which was a major theme of the consultation response that the Government received from the Welsh Assembly Government, as set out in their publication *Economic Renewal: a new direction*. Uncertainty over tax or regulatory changes is damaging to market confidence and prevents businesses from planning with certainty. Providing greater certainty over frameworks is therefore a priority for the Government and will underpin economic recovery, providing a firm base for businesses to invest and grow.

1.3 The Government is also committed to a robust regulatory and competitive framework for the banking sector, with an appropriately phased introduction to mitigate any adverse effects on lending and the economic recovery. This was another important theme in the consultation responses.

1.4 This Chapter will address the main macroeconomic and structural challenges identified in '*Financing a Private Sector Recovery*' and make clear the Government's policies in these areas. The Government recognises that ensuring robust macroeconomic conditions is central to underpinning a balanced recovery, and stands ready to act if conditions require it.

## Banking sector conditions – regulation and financing

1.5 The Green Paper noted that the banking sector is facing significant challenges in restructuring individual balance sheets, including the refinancing of liabilities after the rapid expansion that took place over the last decade. While this adjustment process is currently being supported through the extensive public interventions put into place during the crisis, banks need to prepare for the expiry of Government and central bank support in the medium term.

1.6 Responses to the Green Paper consultation raised the following issues:

- **strengthened banking regulation:** there was broad recognition among respondents that providing stable financial conditions would allow businesses to plan with confidence and should increase investment. Respondents agreed that providing a robust regulatory system is one way in which Government can support stability in the financial sector and long-term economic growth;

- **banking sector constraints:** respondents noted a concern that the availability of credit might be constrained by capacity in the banking sector as the economic recovery gains pace. Respondents listed a number of factors which they thought could increase the likelihood of constrained supply, including expiry of crisis schemes such as the Special Liquidity Scheme; regulatory change (domestically and internationally); overly cautious bank behaviour; high funding costs; potential increases in the base rate; potential effects from high rate of refinancing, should borrowers not deal with refinancing ahead of time; and refinancing of existing leveraged finance; and

- **securitisation markets:** some respondents (mainly banks) commented that a US TALF-style scheme might help new securitisation markets to develop. Other responses raised the point that greater transparency had already started to improve investor confidence and some successful securitisations had been undertaken without the need for Government involvement.

1.7 Ensuring that banks are able to meet the future lending and refinancing needs of creditworthy businesses is crucial, particularly for those firms that lack access to other non-bank sources of finance.

1.8 During the crisis, the authorities extended exceptional levels of funding and liquidity support to institutions to help them work through their balance sheet adjustment on a slower time frame. This adjustment process is taking place over a number of years, reflecting the extensive pre-crisis build-up. The Government expects this to continue for the foreseeable future, particularly as banks make the transition back to wholly unguaranteed funding over the medium term. It is crucial that banks and building societies work with investors and other market participants to restore efficient market operation and ensure that they are able to supply sufficient credit to the economy. The sector has already made good progress over recent months, but authorities will continue to monitor their performance closely.

1.9 The Green Paper noted that securitisation can be an important source of funding for both banks and non-bank lenders, but also that the closure of securitisation markets contributed to the financial crisis. The Government welcomes the steps to improve the securities traded in these markets that have already been taken, both by the industry and by regulators in the UK and internationally. However, the heavy reliance of the UK market on a limited investor base, and in the past on leveraged investors, remains a significant weakness. Such a market cannot be relied upon to act as a stable source of credit for the real economy in the medium term.

1.10 The Government welcomes the acknowledgement in the BBA Taskforce Report of the potential value of "accelerat[ing] recovery in the ABS market through the imposition of uniform asset eligibility criteria, promotion of structural simplicity and expanded/improved disclosure standards allied with undertakings to improve secondary market liquidity." These features are signs of a mature securitisation market, and the advantages of such standardisation have repeatedly been emphasised by many existing and potential new, more stable 'real money' investors in securitisation. They would potentially improve the appeal of securitisations to a much broader range of investors, and might also help address the prudential risks that large, complex, bespoke securitisation structures can pose to the stability of institutions reliant upon them.

1.11 The creation of a more homogeneous, accessible UK market will require the engagement of all UK issuers of securitisations and their investors. The Treasury, the Bank of England and the Financial Services Authority have therefore decided to take forward this process by working with the industry to consider the creation of a more standardised framework for future UK securitisations. This will focus initially on developing common standards for residential mortgage-backed securities, which are the largest market. Wherever appropriate, these standards will seek to draw on existing initiatives, such as the disclosure requirements set out by the Bank of England for the use of securitisations in its operations.

1.12 In facilitating the design and implementation of improvements to future UK securitisations, the authorities will be mindful of the interests of existing investors and the need for an orderly transition, recognising the ongoing need for UK firms to continue to raise funds in these markets.

1.13 Covered bonds can also be a valuable, stable source of longer-term funding for UK institutions. In recognition of this, the UK Regulated Covered Bond framework was introduced in 2008, enabling qualifying UK covered bonds to benefit from recognition in EU legislation. The framework has been a success, with 9 issuers now participating and a total of over £100bn of bonds outstanding.

1.14 The Government is keen to maintain and enhance the attractiveness of the UK covered bond framework to both issuers and investors, and so has decided that the Treasury, in conjunction with the FSA, will conduct a review of the framework. The review will consider how to improve and strengthen the framework, and will cover both the legislation underpinning Regulated Covered Bonds and the FSA's supervision of regulated issuers and programmes under the regime. The Government welcomes the BBA's support for a review in the Taskforce Report. A consultation will take place in 2011.

1.15 The need for substantial and exceptional interventions during the crisis illustrates the need for tighter regulatory changes going forwards. The Basel Committee have recently delivered on an historic and crucial set of reforms that will substantially improve financial stability by helping to address regulatory failings. This set of reforms includes more and better quality bank capital, and for the first time internationally agreed liquidity standards, in addition to a leverage ratio. Our assessment is that the reforms will significantly strengthen financial stability and deliver long-term economic benefit to the UK economy.

1.16 The extended transitional arrangements will mitigate the risk that implementation of the new standards might impede the pace of recovery. Implementation of the reforms is to begin on 1 January 2013 with the package phased in by January 2019. Work by the FSA, Bank and HM Treasury suggests the core Basel III proposals will be manageable for the UK banks and markets expect UK banks to transition to the new regulatory framework better than most European peers.

1. **The Government is monitoring wider macro conditions and the adjustment process by the banking sector closely, as well as supporting businesses through a range of micro-level interventions.**
2. **The Treasury, the Bank of England, and the Financial Services Authority have decided to work with the industry to consider the creation of a more standardised framework for future UK securitisations. They welcome the BBA Taskforce Report's acknowledgement of the potential value of simplifying and standardising UK securitisations to aid the market's recovery.**
3. **The Treasury will also review the UK's covered bond regime in conjunction with the FSA in order to enhance its attractiveness to both issuers and investors.**

## Tax environment

1.17 Alongside the Budget, the Government set out its intention to reform the way that tax policy is developed, marking a departure from the frequent and unexpected tax changes in recent years. It committed to a new approach to policy making to increase predictability and stability, with consultation on policy and scrutiny of legislation as its cornerstones.

1.18 There was broad support for stability and certainty in the tax system amongst responses to the consultation, with respondents noting that this allows businesses to plan with confidence and should increase investment. More specifically, the following issues were raised:

- **having an internationally favourable tax regime:** a number of respondents made the point that having an internationally competitive tax regime is critical to providing a strong business environment. Predictability and stability in tax policy is important, but this should not be at the expense of reforms that would improve competitiveness;
- **avoiding frequent changes to tax regimes:** respondents noted that it takes years for new tax schemes to 'bed in', certainty on future tax policy is important;
- **need to simplify compliance:** respondents asked that effort be devoted by the Government to reduce and simplify compliance requirements. This applies particularly to SMEs, who can frequently face disproportionate compliance burdens; and
- **other issues:** respondents also raised a number of concerns regarding the corporate tax system, the increase in VAT and capital gains tax (with a significant minority of responses calling for a return to taper relief).

1.19 Government recognises that a competitive tax regime is an important part of our approach to creating the best possible environment for a private sector recovery. The Government has already taken immediate action to restore the UK's competitiveness, and to reduce complexity and burdens.

4. The Government has an ongoing commitment to providing a competitive tax regime for business and to increasing predictability and certainty in the tax system, as set out in *Tax Policy Making - A New Approach*.
5. The Government has recently set up the Office of Tax Simplification which will provide advice to the Chancellor of the Exchequer on simplifying the UK tax system, with the objective of reducing compliance burdens on both businesses and individual taxpayers to a Budget 2011 timetable.
6. In addition, Government is committed to continuing HMRC's Business Payment Support Service which is helping meet the needs of individuals and businesses that, because of the economic conditions, are having difficulty in meeting payments.
7. The Government has also set out its aim to create the most competitive corporate tax system in the G20 and the Budget took the first steps to achieving this by lowering the rate of corporation tax to 24 percent by 2014-15. Government has been consulting with business over the summer on the best way to approach reform, and will set out further details shortly.

## Promoting greater competition in banking

1.20 The whole economy benefits from healthy competition in the banking sector. Through stronger competition, businesses can benefit from higher quality products and services, offered at an economically efficient price. Helping markets to work more effectively is a key tenet of the Government's growth strategy and lies at the heart of building a new economic dynamism. Competition also provides opportunities for banks to restore customer trust and confidence in banking services. As set out in the Coalition Agreement, the Government takes competition issues extremely seriously and is keen to promote competition in the banking sector. It is encouraging to see new entrants and other challengers emerging in the retail and business banking markets.

1.21 Some respondents argued that the marketplace was already sufficiently competitive, or that government did not have a role in that area. However, around a third of all responses raised the issue of insufficient competition in the banking system with most considering that this was an area where government intervention could help promote competition. This was a major theme of the Northern Ireland Executive's consultation response, which noted that the problem of insufficient competition in banking is particularly acute in Northern Ireland because of the withdrawal of foreign lenders.

1.22 Consultation responses raising this issue fell broadly into three categories:

- **the range of firms competing for business customers**: many respondents noted the potential for the divestment of branches from the Royal Bank of Scotland and Lloyds Banking Group and the outcome of the Independent Commission on Banking to change the future structure of the market. Many responses highlighted the potential ability of new entrants to offer innovative business models;
- **the different types of finance available beyond bank debt**: many respondents underlined the importance of alternatives to bank debt, but said that many SMEs could not practically access alternative finance without government help. Some suggested extending or creating tax incentives to aid business choice. Others highlighted diverse funding sources such as Business Angels as important and valuable alternate sources of competitive pressure; and
- **measures to facilitate choice and improve transparency**: respondents highlighted that more transparency was needed to empower customers to judge between finance options. Responses focused on the need for changes from both banks and businesses, suggesting that banks needed to share more information both with customers and other banks, such as informing businesses of their credit scores and how to improve them, while businesses needed to develop a better understanding of price and types of finance. Some respondents suggested government organisation or accreditation of financial advisers to ensure businesses had access to impartial and well-informed advice, while others pointed to emerging market-led solutions, including tools such as management account information software and loan comparison websites.

8. As part of the UK banks' Business Finance Taskforce report, 'Supporting UK Business', which was prepared for the Chancellor and Business Secretary, the Government has succeeded in agreeing proposals with the main UK retail banks to publish on a regular basis greater details of bank business lending, to improve customer information and support, and to standardise some of the loan application process.

9. The Government believes that transparency is a more effective weapon than regulation in advancing many policy goals, and that this is certainly true when it comes to bank lending to business. We will therefore give high priority to quickly developing, with the banking industry, regional lending data that will give small businesses the opportunity to make better decisions about where they bank. This will drive up performance and help ensure Britain's businesses get a fair deal.

10. The Government welcomes the Taskforce banks commitments, and will work closely with the banks to ensure that these commitments are implemented in

ways that are meaningful to SMEs. The enhanced data ought, for example, to enable the public to find out for the first time what is happening to business lending on a consistent basis over time and at a regional and sectoral level. In addition, there are some areas identified in green paper responses which the banks have not yet addressed; better customer information and support, for example, should also encompass a commitment to improving small businesses' understanding of price, including fees and charges.

1.23 The Government takes competition issues extremely seriously and will ensure that our review of competition policy looks closely at the banking sector. We also believe that transparency is a far more effective weapon than regulation in advancing many policy goals, and that this is certainly true when it comes to bank lending to business. We will therefore give high priority to quickly developing, with the banking industry, regional lending data that will give small businesses the opportunity to make better decisions about where they bank. This will drive up performance and help ensure Britain's businesses get a fair deal.

1.24 While there has been a trend towards increased concentration in retail banking markets following the financial crisis, the Government is aware that there has also been recent entry and the prospect of further new providers joining these markets. The recent divestment of Royal Bank of Scotland branches to Santander and the upcoming sale of Lloyds Banking Group branches will lead to significant changes in industry market shares. Inward investors and new entrants in retail banking and business finance are operating new business models aimed at restoring customers' trust and confidence in banking services, including some innovative peer-to-peer platforms for SME lending that allow members of the public to lend direct to small businesses and earn a return.

1.25 The BBA initiatives are part of developments in the wider private sector to promote a more competitive marketplace for those seeking business finance. Internet firms, in particular, are looking to match lenders with businesses seeking finance, with websites planned or launching that will allow customers to shop around. In addition, initiatives that encourage better financial management by businesses are developing, from tools for presenting management account information to financial capability road shows. These initiatives will also support the work Government is undertaking to introduce businesses to a wider range of sources of finance.

1.26 One of the areas identified by some respondents was the lack of up-to-date credit risk information on smaller businesses available to finance providers. As a result of the 2002 Competition Commission report on SME banking services, banks agreed that SMEs would be entitled to request, free of charge, an up-to-date credit history of their last 12 months' with their existing bank, twice a year. This could also be sent to as many UK suppliers of banking services as they nominate. It is unclear how often businesses make these requests, or whether this measure has helped to reduce these information asymmetries. The Government will investigate levels of awareness within banks of this tool and take up among businesses.

11. To better understand the challenges these entrants will face, the OFT is undertaking a review of barriers to entry, expansion and exit in retail banking, including both personal and SME banking. The review is looking at the regulatory requirements, access to essential inputs such as IT infrastructure and payment systems, and barriers to achieving scale such as switching and the role of brands and branch networks. The Government expects this review to report shortly.

12. In addition, in July this year, the Government established an Independent

Commission on Banking to consider the future of the industry, including the extent to which large banks gain a competitive advantage from being too big to fail. The Commission has since published an Issues Paper and Call for Evidence, in preparation for the publication of an Options Paper next year. The Commission will present their final report in September 2011.

## Debt Capital Markets

1.27 The Government has been working with industry on ways to promote the use of debt capital markets in the UK. While the majority of respondents did not refer to debt capital markets and viewed it as out of reach for SMEs, a few representative bodies felt that it remained an appropriate financing option for some larger businesses. The Government believes debt capital markets are an important alternative financing channel for larger businesses and is keen to ensure that they operate efficiently. Evidence suggests that although debt capital markets are likely to continue to be relevant only to the largest firms,[1] there may be scope to increase the variety of firms that can access bond markets and privately placed debt.

1.28 UK debt capital markets are smaller relative to those in the US; capital market issuers in the UK are predominantly large companies. In considering how the market could be developed the following areas were the focus of discussion by respondents:

- reaching smaller businesses: most respondents saw debt capital as inevitably out of reach of SMEs and smaller mid-sized corporates. One felt this could be addressed through using a government agency to raise debt in the capital markets on their behalf on a syndicated basis; others suggested creation of a specific credit rating for SMEs and mid-caps, to overcome their disadvantages in current credit systems and give a basis for investor confidence;
- education: many respondents felt that more awareness of capital markets was needed, and some offered support for a government-led public awareness campaign to raise consumer demand for bonds;
- regulation: respondents were divided, with some arguing that reduced regulation would streamline the markets, while others backed more regulatory pressure on financiers to make sure they were explicit about what they were offering; and
- tax: several respondents suggested that non-traditional lending in general suffered from tax disadvantages relative to mainstream bank lending, or argued that tax incentives were needed to invigorate the market.

1.29 Evidence from the US shows that, compared to the UK, between 15 and 20 percent more US companies with a market capitalisation equivalent to around £100 million issue public debt. There are already encouraging signs that the financial sector is finding its own solutions in these areas. There was a record volume of bond issuance in 2009 and so far this year a record 42 per cent[2] of UK debt capital market issuances have been by new first time issuers compared to an average between 2000 and 2009 of 17 per cent. Data also indicate that these markets have been increasingly frequently tapped by smaller issuers. The Government will continue to monitor these encouraging market developments.

[1] See the "Discussion paper on non-bank lending" published by HM Treasury in January, which set out the evidence in this area – the paper is available here: http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/fin_non_banking.htm

[2] Dealogic, Bank of England.

1.30 While there may be scope to widen access to debt capital markets for UK companies, it is always likely to be uneconomic for small companies to access debt capital markets directly. The infrastructure of the banking sector is best placed to achieve the economies of scale needed to overcome the large fixed costs of originating and monitoring the credit risk of smaller companies. The financial sector has shown signs of developing initiatives which seek to overcome these problems. For instance, a number of funds have sought to buy legacy loan pools/funds in the wholesale market (predominantly from banks). However, there may be a need for more to be done to help financial institutions to develop ratings systems for businesses smaller than those currently available to channel finance from non-bank and real-money investors to smaller companies.

13. The Government welcomes ongoing industry efforts to promote the development of corporate debt capital markets in the UK, and will actively support the industry in taking further steps to:

- raise awareness of the diverse sources of finance, including non-bank investors, available to companies;
- improve bond market efficiency and minimise the burden of regulatory compliance, through better adaptation and standardisation of bond documentation and better information flows;
- develop deeper sterling bond markets, for example a private placement market for mid-sized companies. This would include encouraging the market-led development of a broader, more sustainable issuer and investor base; and
- develop wholesale market corporate-debt financing mechanisms.

# 2 Help for firms facing the greatest challenges: Small and Medium-sized Enterprises (SMEs)

2.1 The majority of respondents concentrated on issues affecting small businesses, with a range of suggestions made as to how to improve the supply of finance for small businesses. These responses commonly focused on ways of increasing access to debt finance, equity and growth capital. Accordingly, the Government's response focuses most strongly on these areas of finance.

## Promoting access to equity finance

2.2 Equity is an important source of finance for investment and growth, at all stages of the business life cycle, although it is particularly important for early-stage higher risk businesses that offer the best potential for higher returns. In such cases, it can also be a more appropriate source of finance than debt, as it does not require immediate repayments, making it particularly suited to small businesses with high growth potential that are not yet generating sufficient revenue to service debt. It can also be useful for established small businesses that are restructuring or expanding, and which lack the capital base to access further bank finance.

2.3 Small businesses may need successive rounds of equity finance as they grow, and many currently face 'cliff edges' when one source of finance is exhausted. This can lead to stagnation of companies that would otherwise have grown rapidly as management time and focus is diverted away from growth and expansion plans towards finding the next equity investor. To cope with these challenges, current investors are sometimes forced to extend their financing of such firms, limiting their ability to invest in other, new businesses. To foster growth, Government is focussed on supporting the development of a sustainable 'funding escalator' with flexible solutions for start-ups through to established, growing businesses. Evidence shows that there is a missing market or equity gap in the supply of equity finance at each of these key points, and this has also been highlighted in the responses to the Green Paper. The Government's response also focuses on ways to improve access to public markets for SMEs and to increase the availability of information for investors about SMEs who are on public markets.

## Business Angel investment

2.4 Business Angel investment is the first stage of the equity funding escalator (typically up to £200,000, but higher with syndication). Respondents considered Angel investment to be an increasingly important source of equity finance over the last decade, with the first-ever UK-wide study conducted last year estimating Angel investment to be worth around £430 million to UK SMEs in 2008-9.[3] Angel investing is particularly important for new businesses, with experience from the US suggesting there is room for their role to grow further. Exchange-regulated markets

[3] Annual Report on the Business Angel Market in the UK 2009/9, by Colin Mason (University of Strathclyde)and Richard Harrison (Queen's University Belfast) on behalf of BIS, the British Business Angels Association, LINC Scotland, the British Venture Capital Association and the Association of Chartered and Certified Accountants. This may be a conservative estimate. Other commentators estimate that the figure may be closer to £1billion. This may be a conservative estimate. Other commentators estimate that the figure may be closer to £1billion.

(such as AIM and PLUS-quoted) can act as an important link between smaller companies and the main markets, which is useful to Business Angels.

2.5 There was support from respondents for a range of measures to facilitate increased Business Angel activity, including changes to tax-advantaged equity schemes, regulatory changes, and the creation of new forms of co-investment funding to increase capacity and reach of Business Angel investments in higher risk companies. The consultation response from the Scottish Government noted the success they have had with the Scottish Co-investment Fund in developing the Business Angel market in Scotland. Others called for the 'professionalisation' of the market through measures such as encouraging the use of gatekeepers to facilitate and lead syndicates of Angels. Some respondents believe that Business Angel networks are not viable without public support, although with an acceptance that networks will have to demonstrate real action and self-reliance over the longer term to receive such support.

14. The Government recognises that Business Angels are an important source of early stage investment for small businesses. The Government will encourage business angel groups and the Government's SME investment arm – Capital for Enterprise Ltd - to put together a bid to the Regional Growth Fund for a Business Angel co-investment fund. If successful, this will support angel investments into high growth potential early stage SMEs, particularly in areas worst affected by public spending cuts. The Government believes this is the kind of activity that would be well placed to take advantage of the Regional Growth Fund application process.

15. The Government will review the impact of the regulatory framework on intermediaries within the Business Angel market.

16. Through a network of 'Growth hubs' the Government will deliver tailored specialist advice to improve the 'investment readiness' of small companies, making them more aware of equity as a source of finance; developing their management teams and business models; and improving their skills and capability to pitch to Angels and venture capital funds. Growth hubs will also bring together Angel networks and growth-potential small businesses; and establish and strengthen investor networks, such as Business Angel networks including through supporting new business angels via investor education and mentoring.

2.6 Respondents to the Green Paper strongly supported the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) schemes, and thought that they were effective in incentivising equity investment in small companies. For example, a number of Business Angels utilise the tax incentives available for equity investment – a recent survey found that 76 per cent had used the EIS for at least some of their investments. Some respondents felt that the scope of these schemes, especially EIS, should be widened to include debt investments and preference shares, and that some of the restrictions on the size of company that should be invested in could be loosened. Others felt that targeted increases in the amount of tax relief available to investors, or additional technical changes, would improve the delivery of the schemes. Other tax-related proposals included the total or partial abolition of stamp taxes on shares, and changes to Capital Gains Tax and ISA rules for shares in smaller companies.

17. In response to these representations, the Government will continue to ensure that the targeted tax incentives for investment, the EIS and VCTs, effectively meet their objective of incentivising additional equity investment into small companies, and will continue to seek viable options to ensure the tax system supports, where possible, access to equity finance for SMEs.

18. More generally, the Government is committed to restoring the UK tax system's reputation for predictability, stability and simplicity. Alongside the Budget, the Government published a discussion document on improving tax policy making, which set out a range of proposals for improving our approach to tax policy, with consultation on policy and scrutiny of legislation as the cornerstones.

2.7 Over the past few years, there has been a movement away from early stage venture capital from the private sector towards larger, less risky, and often leveraged investments. Many respondents have therefore commented that publicly supported funds are 'the only game in town.' Government-backed funds account for 60 per cent of the sub-£2 million market. Enterprise Capital Funds (ECFs) are specifically designed to support high growth potential businesses that may not otherwise be able to access finance up to £2 million to help them to grow and prosper. The ECF programme can also complement Business Angel investments. There are currently nine Enterprise Capital Funds operating with a government commitment of £156m.

2.8 The programme puts public money alongside private investment in order to enhance private investors' expected returns and so attract them to an area in which they would not otherwise invest. The programme is designed to be cost neutral for taxpayers over the medium term and is expected to attract good quality venture capital management teams to invest in the equity gap. ECFs operate on commercial grounds. The Government provides up to two thirds of the capital in each ECF and takes only a limited share of the profits in order to encourage private investors to participate where they would not otherwise. The involvement of professional fund managers and private investors ensures that investments are made on sound commercial terms.

2.9 More generally, the Government will continue to review its provision of equity finance products for SMEs to ensure that these are effective and accessible for UK businesses.

19. Responding to calls for continued support in meeting the equity gap, the Government has committed to continue with the ECF programme through the next four years and will contract with fund managers to deliver further early stage equity support to growing businesses. The Government will increase its commitment for the Enterprise Capital Funds by £200 million, which will provide investment into the equity gap of more than £300 million for early stage innovative SMEs with the highest growth potential. The ECF programme will continue to focus on addressing a long-term structural weakness in the provision of risk capital to SMEs across a range of sectors and in all parts of the country, investing in good businesses wherever they are located.

2.10 In addition, the European Commission has recently agreed to increase the permitted amount that may be invested in SMEs under state aid rules and to consider increased flexibility for Government-backed equity finance programmes across the EU. This should allow for programmes such as the Enterprise Capital Funds to invest larger amounts in individual businesses from the start of 2011 and for the provision of growth finance or more follow-on funding for supported businesses from 2013.

2.11 Private sector venture capital funds are more active when it comes to larger investments. However, evidence shows that businesses operating in sectors that require complex research and development or large capital expenditure or significant follow-on funding – for example, clean technologies or biotechnology – typically face an equity gap that is larger than that facing other businesses, and which can extend up to £10 million.[4] The UK Innovation Investment Fund (UKIIF) was specifically created to address this financing need – to drive economic growth and create jobs by investing in technology-based businesses with high growth potential. The UKIIF also marks a step-change in UK venture capital by creating a fund that replicates what the best US funds already do: making investments at all stages, with the kind of scale that can build businesses with global reach. This Fund has now begun investing into high-tech, innovative UK businesses.

2.12 The UKIIF is made up of two funds of funds, managed by two private sector fund managers – Hermes GPE and the European Investment Fund. The Government has invested £150 million as a cornerstone investment for the UKIIF, with £100 million from Department for Business, Innovation and Skills, £25 million from the Department of Health and £25 million from the Department for Energy and Climate Change. The two fund of funds raised £175 million of private investment, leading to a combined total of £325 million to invest at first closing in 2009.

2.13 The Government is pleased that it in a short amount of time, both funds of funds have made their first investments. The Hermes Environmental Innovation Fund (£125 million) is focussed on increasing the efficient use of resources and the development of clean technologies and is a major boost in the transition to a low carbon economy and it made its first investment into WHEB Ventures' second clean technology fund. The European Investment Fund's UK Future Technologies Fund (£200 million) will invest in a number of specialist technology funds such as life sciences, digital technology and advanced manufacturing. It has made two investments – one into the DFJ Esprit III Fund and one into Acton Capital Partners' Heureka Growth Fund. Both the funds of funds and the underlying funds are continuing to undertake due diligence on future investment opportunities.

## Ensuring that established businesses have access to finance for growth

2.14 The 2009 Rowlands Review identified a structural gap in the provision of equity finance, or growth capital, for established, growing businesses. This financing gap was previously partly disguised by banks providing debt finance in this space prior to 2007.

20. The Government has encouraged seven main UK banks to establish a £1.5 billion equity fund, to be known as the 'Business Growth Fund': this will be paid for entirely by the banks, without the need for a taxpayer contribution. This will help to repair the balance sheets of established and growing SMEs and, in turn, help them to access greater bank debt finance. The Fund will be targeted at the growing small and mid-sized businesses that contribute to economic growth. The Government will also seek to increase the scope of this commitment by working with the European Investment Fund (EIF) to secure additional investment.

[4] See, for example, '*The Supply of Equity Finance to SMEs: Revisiting the Equity Gap*' SQW Consulting, 2009.

2.15 The Fund will address the policy aims that Government sought to address through the Growth Capital Fund and, as such, will replace the Government's previous plans announced in the Budget to progress the Growth Capital Fund. This Fund will provide flexible equity finance for businesses with an annual turnover of between £10 million and £100 million with high growth potential. The fund will be evergreen, investing its profits, and the aim is that it grows into a large scale, source of equity funding for UK firms, and can also function as a credible channel for capital investment from sources other than banks. The Government welcomes the Business Growth Fund and acknowledges the important role it will be filling in the equity funding escalator.

## Improving access to public markets

2.16 Respondents felt that current listing requirements led to compliance costs (legal, accountancy, advisory) which were disproportionately high for SMEs. However, respondents felt that the current regulatory obligations for listing on exchange-regulated markets (AIM and PLUS quoted) strike an appropriate balance to maintain investor confidence, and that to reduce compliance obligations could be counter-productive.

21. The Government is keen to minimise regulatory burdens for SMEs, and as such is engaging constructively on this front with the European Commission and other Member States on the forthcoming reviews of the Markets in Financial Instruments Directive and the Transparency Directive will provide opportunities to develop proportionate obligations for SMEs while maintaining investor confidence.

2.17 The Prospectus Directive is the EU framework for the preparation of prospectuses in public offers of securities and where securities are admitted to trading on a regulated market. In 2009 the European Commission published proposals to simplify and improve the application of the Directive. The revised Directive has now been agreed and national Governments have 18 months in which to implement the new Directive. However, the Government is demonstrating its support for SMEs in the context of the regulatory framework by introducing two elements of the Prospectus Directive early.

22. The Government will introduce two elements of the Prospectus Directive early, as these will be beneficial to companies. The threshold for an offer of securities for which a Prospectus is required will be raised from €2.5 million to €5 million. Furthermore the minimum number of investors for which a Prospectus is required will increase from 100 to 150 investors. These measures will particularly benefit SMEs. The Government will consult early next year on implementing these changes.

## Supporting bank lending to small businesses –the Enterprise Finance Guarantee

2.18 The Enterprise Finance Guarantee (EFG) supports lending to viable small businesses that have insufficient collateral or financial track record to access a commercial loan. Respondents were broadly supportive of the EFG as it currently operates. However, some concerns were raised regarding the lack of clarity around the rules around the requirement for guarantees; the fact that banks were unwilling to lend to companies based on intangibles such as track record, which is especially problematic for the creative industries, IT sectors and young entrepreneurs; and that the cap on the Government liability had reduced banks' capacity for risk and deterred them from using EFG. Finally, it was suggested that banks used the scheme for larger loans to established businesses and that part of the scheme should be set aside for start-ups. Some respondents also said that start-ups might benefit more from support for mezzanine or equity finance rather than debt.

2.19 The Government will continue to support lending to viable small businesses that lack collateral or track record through the EFG. The Government will also work with lenders to ensure the criteria for the EFG is clearly understood. The Government has seen no evidence that lenders are being inhibited in their use of EFG because of the cap and believes it is important there is an appropriate sharing of risk between Government, lenders and small businesses. It is in the interests of the taxpayer for the Government's exposure to be limited to levels which reflect the default rates of banks' wider SME lending book. However there is a case for raising the default rate for smaller lenders who are less able to diversify risk across a large EFG lending portfolio. Small businesses with a turnover of under £1 million have received 70 per cent of all EFG-backed loans to date, and as such, the Government does not consider that EFG is being overly-concentrated on larger, established businesses.

2.20 The Government is also pleased to note the success of the new EFG loan processing target introduced in the June Budget, with all major EFG lenders now ensuring that EFG applications are processed within 20 working days. This is helping to give businesses the certainty and assurance they need when using this scheme. The Government will continue to review the operation of the EFG to ensure that it is operating effectively for UK businesses.

23. The Government is pleased to announce continued support for the Enterprise Finance Guarantee (EFG) over the next 4 years to enable lending to viable small businesses that lack collateral or track record. The EFG scheme will provide £600m of additional lending to around 6,000 SMEs next year alone and, subject to demand, over £2 billion in total over the next 4 years.

24. Smaller and specialist lenders under EFG make only a few EFG-backed loans each year. These lenders are not able to manage their risk by building a portfolio of EFG-backed loans in the way that larger lenders can. This can discourage smaller lenders from using EFG. To enable smaller and specialist lenders to participate fully as EFG accredited lenders, the level of payouts that Government will make against defaults will increase from 13 per cent to 20 per cent for the first £1 million of EFG-backed loans made by every lender accredited under the scheme. This should support more small and specialist lenders to use the scheme.

25. In addition, Government will work with the BBA to explore a commercial scheme based on the successful Enterprise Finance Guarantee for businesses seeking working capital to fund exports. The conclusions will be included in the trade finance White Paper.

26. The Government also announces that the Departments for Business, Innovation and Skills and Culture, Media and Sport will work together to understand whether creative businesses are suffering more than others in accessing financing. This review will be carried out to a Budget 2011 timetable.

## Promoting greater use of new sources of working capital

2.21 Some Green Paper respondents suggested that **Supply Chain Finance** (SCF) could be a valuable addition to the diversity of finance available to small businesses. Several respondents also put forward their own proposals for SCF tools. The Government recognises that SCF allows greater flexibility in payment terms and can constitute an important source of working capital for businesses. However, although the SCF market is heterogeneous, with a variety of products available and might currently be under-utilised due to low understanding and some negative connotations attached to this type of finance.

27. To support and raise awareness of SCF, the Government will bring together corporates, suppliers and potential investors and encourage market-driven solutions. The Government is also keen to ensure access to local sources of finance for small businesses and will explore the scope for SCF solutions at a local government level, building on the success of public sector examples.

## Encouraging social lending and enterprise in disadvantaged areas and areas affected by public sector cuts

2.22 The Government recognises that Community Development Finance Institutions (CDFIs) can play an important role in facilitating access to finance in disadvantaged areas and to disadvantaged groups. CDFIs provide loans to start-up businesses, individuals and established businesses that are unable to access finance from more traditional sources, such as commercial banks. Responses from CDFIs suggested more support should be available to support lending to these groups. Some respondents also called for a continuation and improvement of Community Investment Tax Relief, which has State aid clearance up to 2012, and changes to the Enterprise Finance Guarantee to ensure that it focuses on smaller higher risk businesses.

28. To encourage access to finance in disadvantaged areas, the Government is considering changes to the EFG to make it easier for CDFIs to lend to a wide range of small businesses (see above). The Government is also contributing to the European PROGRESS Microfinance Facility, which CDFIs can bid to for support, and is currently developing the Big Society Bank, which will be established in Spring 2011. The Government will continue to work through existing financial intermediaries, including CDFIs. The Government is also committed to considering the future of the Community Investment Tax Relief scheme.

## Finance for Exports

2.23 International trade finance provided by banks and related financial institutions is crucial and underpins around 30 per cent of world trade. In the UK, as globally, reduced liquidity and increased perceptions of risk as a result of the economic crisis has meant less trade finance being available, and where it is, it costs more. This shortage of trade finance contributed to the dramatic decline in global trade in 2008-9. This has been reflected by respondents, particularity by some SMEs who have found accessing trade finance to be a struggle. Respondents said that SMEs looking to access new markets, in particular in the big emerging markets of Brazil, Russia, India and China (the ‘BRICs’), had less support than in some other EU member states. This is of concern as the financial recovery has accelerated in the BRICs, and so there are likely to be missed opportunities for profit.

2.24 Respondents felt trade finance was limited for businesses without experience in international trade, especially SMEs, noting this was partially due to a lack of awareness, but also because the options available had become more limited. Help from the Export Credits Guarantee department was deemed rarely appropriate for SMEs, due to its long-term timeframe and focus on major capital projects. It was also noted that banks were not interested in smaller quantities of trade finance. Respondents raised concern about support available to UK SMEs compared to that offered by other EU member states, for those looking to access markets in the BRICs in particular.

2.25 Most respondents felt that there was space for government action. Suggestions included a government sponsored bond support facility (as occurs in some other EU Member States); a dedicated export aspect to the Enterprise Finance Guarantee Scheme, or possibility of a business involved in export at least applying for a loan under the scheme; a further broadening of the product range offered by ECGD as well as their client base itself; more HMG steering of potential exporters to countries where opportunities exist with risk management and funding to support export contracts; closer interaction between UKTI and regional trade support with banks and other trade finance providers to give businesses a suite of integrated business support; and loan guarantees to back up large export contracts, as offered by other governments.

29. Promoting UK businesses' access to the export finance they need is of central importance to our economic growth. UK businesses need to be confident that they can compete with their international colleagues and can take advantage of export opportunities. In response to concerns raised Government is taking the following steps:

    - the Export Credits Guarantee Department (ECGD) is considering how a Bond Support scheme might operate, and is discussing with the BBA and exporter groups how such a scheme could most effectively be delivered for British exporters.;

    - the Government will ensure that ECGD has the capacity to continue to meet the increased demand for its current range of services following the financial crisis. ECGD's current levels of business are over 50 per cent higher than before the crisis; and

    - respondents raised concerns there was a lack of awareness and options amongst businesses, particularly SMEs. Working alongside banks, ECGD and UK Trade and Investment are seeking to raise the awareness of trade finance products available to businesses, particularly SMEs, who predominantly are currently using riskier open account trading.

    - UKTI is working on a new strategy to ensure they are focusing their services on the correct export markets, particularly high growth emerging markets, where opportunities for UK businesses are growing substantially. UKTI currently operates a Gateway to Global Growth Scheme that assists SMEs to maximise opportunity and reduce risk when entering new markets.

30. Government will respond more fully on the challenges for international trade in a White Paper on International Trade in 2011.

## Supporting demand for finance – investment readiness support

2.26 In addition to highlighting the need for a greater supply of finance products for small businesses, respondents also highlighted the need for more demand-side support – particularly in relation to repairing relationships between businesses and banks and supporting investment readiness among small businesses.

2.27 Many business advisors, investors and representative bodies commented that small businesses often saw finance as either a term loan or an overdraft from a bank, and were not aware of the alternative sources of finance available to help them manage cash flow and to invest. In addition, respondents noted that one of the largest barriers to businesses accessing growth finance, was an aversion amongst small and mid-sized companies (particularly those that are family owned) to dilute control through accepting third party equity.

2.28 Investment readiness – being comfortable with the concept of third party equity, meeting appropriate standards of governance and being able to describe and communicate a business opportunity to attract investors – was therefore key to ensuring that more small businesses made use of this type of funding. Most respondents thought that government support in this space should be focused on firms with high growth potential. Some respondents commented that investor readiness was also important, particularly among Business Angels.

31. The Government is keen to support high growth potential businesses become more investment ready and able to access equity finance. The Government will establish a network of Growth hubs to provide intensive support to high growth potential businesses across the country. Growth hubs will play an important role in improving the information available to businesses and in linking them with local, potential investors. The Government is pleased to note the many private sector-led initiatives that are now under way and is keen not to crowd out private sector activity in this area.

32. The Taskforce banks have committed to the funding and creation of a network of business mentors to provide financial advice to small businesses, to support the Government in this area, working with other organisations such as the Federation of Small Businesses and the Prince's Trust.

33. The Taskforce has also committed to the more active signposting of information about alternative sources of finance – including equity finance – by banks to their small business customers, and to highlighting what finance products will best meet their needs. Additionally, Goldman Sachs is now piloting a small business support program in Yorkshire and Humber. This programme offers a four month business education to businesses with serious growth potential and includes follow-up support in a range of areas from legal to finance-raising and mentoring. The programme is designed to equip small businesses for job creation by strengthening their management capabilities and ability to attract investment.

34. In combination with the Growth hubs (discussed above), these privately-led measures should significantly increase the investment readiness support available to small businesses and are welcomed by the Government.

## Information asymmetries

2.29 Many respondents felt that the investor base for SMEs should be diversified, and that improving the information available to individuals, including Business Angels, was important in that regard.

2.30 The localised focus of the Growth hubs, discussed above, offers the opportunity to raise awareness amongst local Business Angels and other early stage investors of opportunities to invest in local SMEs. Almost all responses to the Green Paper that mentioned regional stock exchanges (around a quarter) did not favour the introduction of Regional Stock Exchanges stating concerns that such exchanges would suffer from serious liquidity problems and were not an appropriate solution to the problem of supplying finance to small businesses at a regional level.

2.31 Some respondents felt that it is important to attract a wider range of investors, including retail investors, for SMEs which are listed on markets by reducing information asymmetries. Some suggested that there needs to be a cultural shift towards empowering and enabling individual investors to invest in SMEs and SME funds. It is important to ensure that individuals have access to appropriate information so that those with the means and appetite to contribute to SME growth are given the opportunity to do so.

35. To ensure that individual investors are empowered and receive appropriate information, the Government will engage constructively on the reviews of European Directives that govern information disclosure; the Markets in Financial Instruments Directive (MiFID) and the Transparency Directive.

36. To help facilitate regional and local investment, the Government will work with the London Stock Exchange and the PLUS Stock Exchange to make data and information on local businesses available regionally and to showcase the range of opportunities available to businesses seeking finance.

## Repairing the relationship between businesses and banks

2.32 Ensuring that the UK has a banking system that is transparent, with clear standards against which businesses can hold banks to account, will help to restore confidence. This was a strong theme emerging from the consultation, with around a third of responses complaining of insufficient transparency, for small businesses particularly, over the loan application process, lending rates and the reasons for rejected loan applications. Respondents also commented on the severity of the breakdown in the relationships between businesses and banks over the past two years, and that some identified bank behaviours could pose a risk to business access to finance in the future.

2.33 Responses focused on three areas:

- **better communication and support:** most respondents felt businesses needed more transparency on bank processes, especially risk assessment. They stated that loan applications should be dealt with swiftly, on a clear basis, and that feedback should be given so that businesses could improve unsuccessful applications. Respondents argued that banks needed skilled local relationship managers who had the responsibility to make decisions and could build long-term relationships with business, rather than relationship managers, who were seen as too driven by immediate sales. This was seen as important in terms of building relationships and trust as well as keeping customers informed. Respondents also said that banks should explain other sources of finance and signpost customers to suppliers;

- **fairer assessment of risk:** respondents felt that risk assessment decisions often lacked impact from a local relationship manager who knew the business, and were too often based on a purely automated process that ignored the strengths of individual businesses, as well as lacking sectoral awareness. Respondents also said that too much weight was placed on past performance, without taking into account future prospects. Respondents also raised concerns about an over-reliance on real estate and personal guarantees as security;

- **transparency, accountability and redress:** respondents identified a need for more comprehensive data on bank lending. They suggested that current bank charters on SME lending have not substantially improved trust, and that banks needed to be more publicly committed to the Lending Code, and report performance against it. Respondents suggested that more effective redress was needed: some suggested the Financial Ombudsman Service should publish complaints data more often and turn around cases quicker, and that it should be given more teeth. Others suggested new regulators or financial penalties for banks that did not follow codes of practice. Some respondents also raised concerns about higher margins and one-off fees being charged in order to recapitalise bank balance sheets.

37. The Government is keen to see an improvement in the relationships between businesses and banks and welcomes the BBA Taskforce's set of measures to improve the transparency and credibility of bank commitments in their dealings with customers, including:

    - Revised lending code, incorporating new commitments to micro-enterprises and extension of lending principles for larger SMEs;

    - Establishing a Business Finance Round Table, to report into the Government's Small Business Economic Forum, helping businesses and representative bodies to scrutinise lending practices;

    - New internal appeals processes independently monitored against common standards;

    - Commitments to provide guidance pre-application and personalised feedback and signposting on declined credit applications;

    - Measures to enable businesses seeking to refinance to enter dialogue with their bank about their needs 12 months in advance; and

    - A dedicated website to draw together and link useful sources of information including signpost to alternative sources of finance, giving customers helpful information and advice if a loan is declined and raising awareness about different financial options.

38. The Government will continue to work with the BBA and the banks to ensure these commitments are delivered quickly and that momentum is not lost. The Government is also keen to see the BBA go further in some areas – and particularly public disclosure around the appeals process, to give greater confidence to business that this process is working.

39. The Government has responded to the independent review of the Lending Code stressing the need for a more visible and transparent code.  The Government is keen to ensure the transparent enforcement of the Lending Code by the Lending Standards Board, and clarity on how the broader lending pledges will be applied for larger SMEs. The commitment to having an appeals process where 'a second pair of eyes' looks at credit issues is very welcome, and robust independent monitoring of this will be essential.

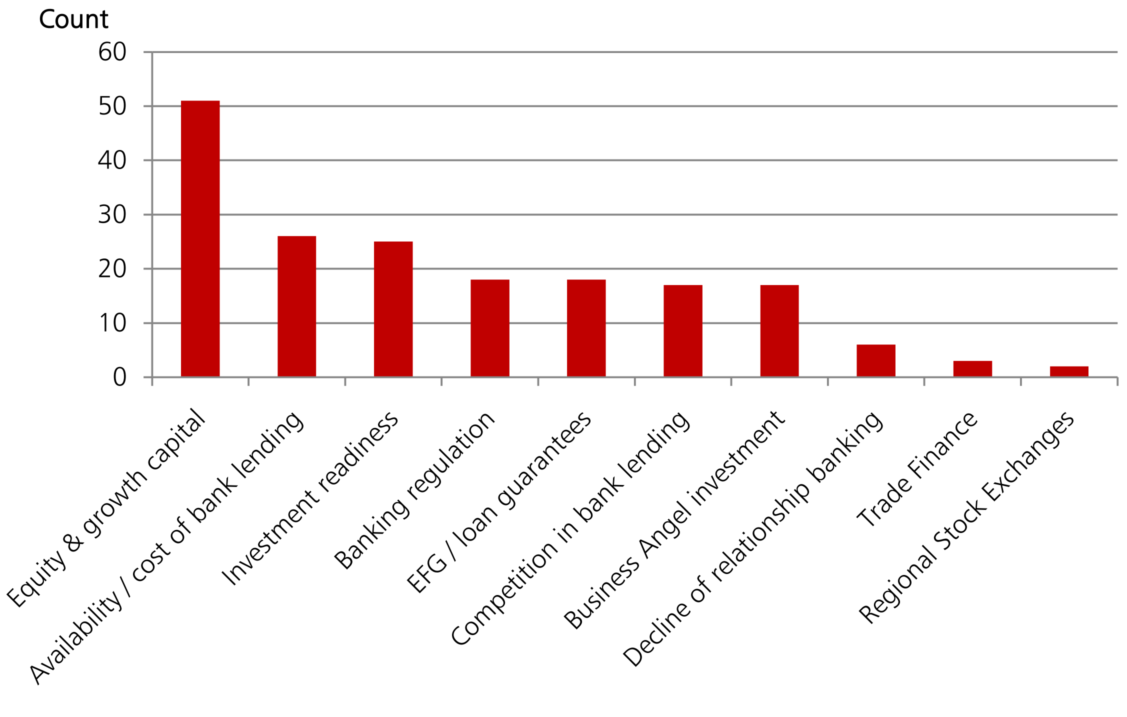
40. The Government will also promote transparency with regards to how banks are performing across the different regions and sectors of the UK economy. The BBA Taskforce commitments included an agreement for banks to sponsor a regular business survey assessing demand conditions.

# A Further quantitative analysis of responses

A.1 183 responses to the Green Paper were received in total. Although on average each response covered three topics (with a significant minority covering all areas of the Green Paper consultation), categorising each response loosely according to the main topic addressed in each gives the counts shown in the Chart A.1 below.

A.2 The most common focus was the availability of equity and growth capital for SMEs, followed by concerns about the availability and cost of bank lending.

**Chart A.1: Responses by main topic**

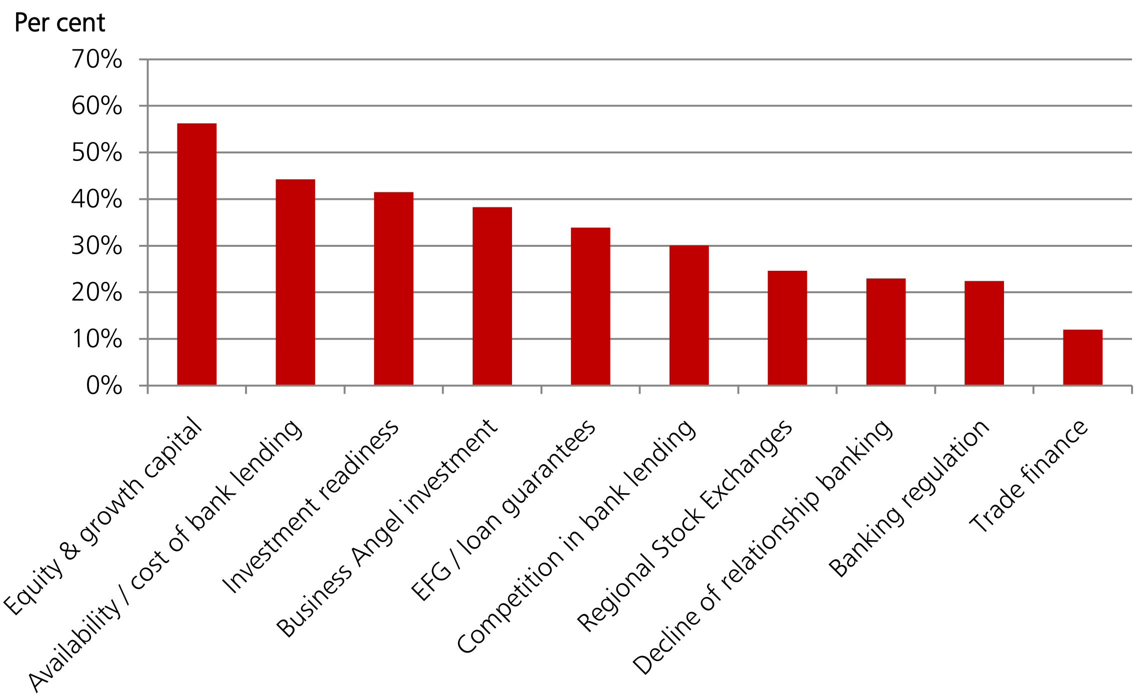



*Source: HM Treasury*

A.3 A slightly different way to analyse the themes of the responses is shown in Chart A.2. It shows, for example, that around 55 per cent of responses raised the issue of equity and growth capital for SMEs (though not necessarily as the main topic of the response).

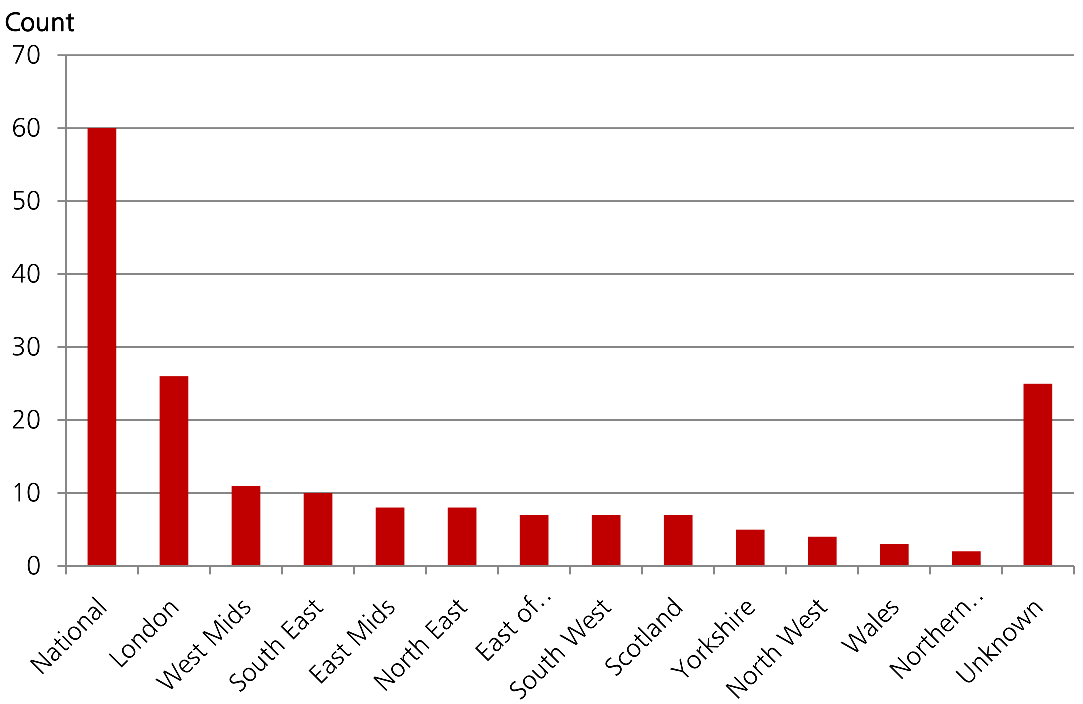
A.4 Although this is a very similar analysis to Chart A.1, you can see, for example, that regional stock exchanges was raised as an issue in nearly a quarter of responses even though it was the main focus of only a few.

**Chart A.2: Percentage of responses that covered each issue**




*Source: HM Treasury*

**Chart A.3: Responses by region**

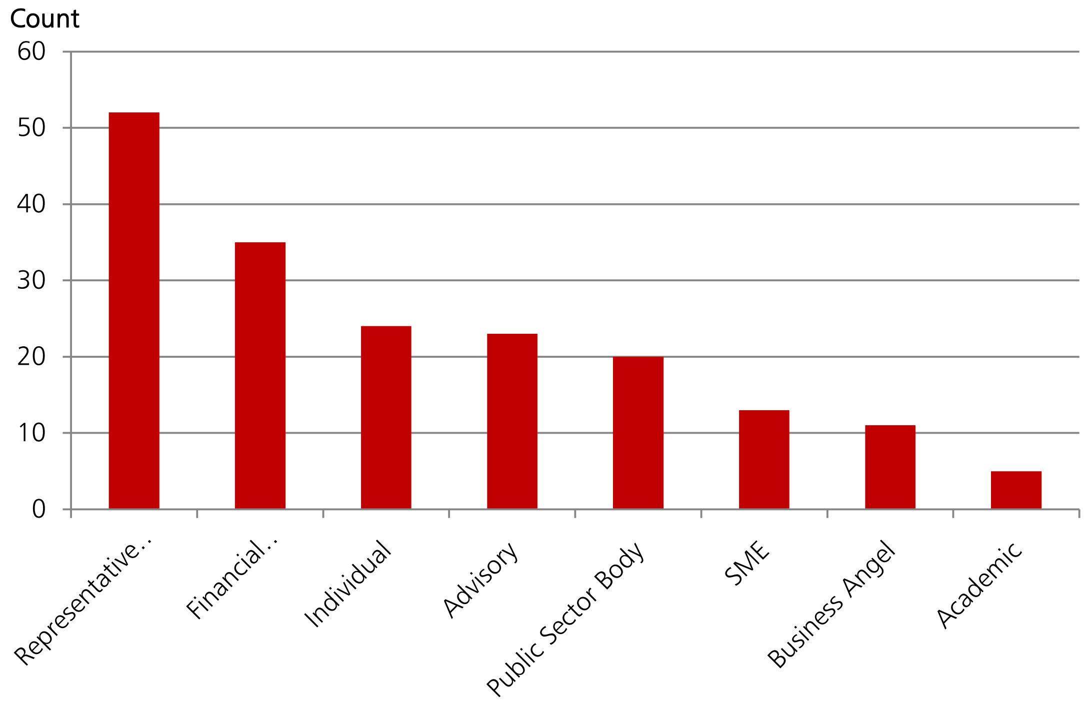



*Source: HM Treasury*

A.5 Chart A.3 breaks down the responses by region. The largest group of responses came from national bodies, such as business organisations, followed by responses from London. The relatively large amount of "unknowns" were due mainly to the responses from individuals, where frequently an address was not supplied.

A.6 Finally, Chart A.4 breaks down the responses to the Green Paper by the type of respondent. Representative bodies and financial institutions / investors were the largest groups. The category "Advisory" refers to consultancies and accountancy firms.

**Chart A.4: Responses by type of respondent**




*Source: HM Treasury*

# B List of responses

1 Tim Hill
2 Camrose Consulting
3 Graham Skinner
4 Professor Andy Mullineux
5 Gordon Forrest
6 pmt sales/egame media
7 Hugh Smith
8 Joseph Bergin
9 Philip Dews
10 George Edwards Consulting Limited
11 Stephen Hazell-Smith
12 ACM Catalyst Limited
13 The Mentor Bank
14 NBV
15 Matthew Broughton
16 Roger Moore
17 Beer and Partners
18 Chris Benjamin
19 Melinda Atkinson
20 Donald R Clarke
21 Simon Mackenzie
22 Marcus Macleod
23 Derek French
24 Campaign for Community Banking Services
25 Nick Richards
26 LINC Scotland
27 Signs Express Limited
28 Johnnie Cook

29 Chris Clegg

30 Mercia Technology Seed Fund

31 Future Route Limited

32 Paper Mountain Solutions

33 John Van Reenen

34 Access to finance expert group

35 The Survey Association

36 John Robertson

37 Renato Pomposelli

38 James Nicholson-Smith

39 Sustainable Ventures Limited

40 BailoutSwindle.com

41 ICMA Covered Bond Investor Council

42 PBS Manufacturing Limited

43 George Caldicott

44 UKFunders

45 Growth Investment Network East Midlands

46 Sussex Place Ventures

47 Matrix Private Equity Partners LLP

48 Association of Investment Companies

49 Oxford Spin-out Equity Management

50 Third Horizon Consulting

51 Connect Midlands

52 SME Wholesale Finance (London) Ltd

53 Society of Motor Manufacturers and Traders (SMMT)

54 Tyne and Wear Enterprise Trust Ltd

55 Fluid Dynamics International Inc

56 Barnsley & Rotherham Chamber of Commerce

57 UK Music

58 Altitude Partners LLB

59 Ernst and Young

60 Albion Partners LLB

61 IFG Capital Limited

62 Black Country Reinvestment Society

63 British Private Equity and Venture Capital Association (BVCA)

64 Capitalise Business Support

65 Connect Yorkshire

66 Forum of Private Business

67 Global Settlement Network

68 Inngot

69 NEL Fund Managers

70 Northstar Ventures

71 Oxford Innovation Limited

72 Paul Dare

73 PLUS markets

74 Scottish Government

75 South West Investment Group

76 Wine Intelligence Ltd

77 Northwest Regional Development Agency

78 Ascendant Ventures

79 Isis Innovation Ltd

80 Fair Finance Consortium Limited

81 Northern Ireland Assembly

82 Stockopedia Ltd

83 Peter Watson

84 group of Regional Fund Management Companies

85 Maven Capital Partners UK LLP

86 Grant Thornton UK LLP

87 Business Link Northwest

88 British Franchise Association

89 Abertay University

90 Darran Foxton

91 Braveheart Investment Group plc

92 Federation of Small Businesses

93 Finance Wales

94 The City Disputes Panel

95 The Building Societies Association

96 ISIS Equity Partners

97 Engineering and Machinery Alliance (EAMA)

98 Bibby Financial Services Limited

99 The Northern Way

100 E-Synergy Limited

101 London Technology Fund

102 3i Group plc

103 Blue Sky Corporate Finance Ltd

104 East Midlands Development Agency

105 Mutuo

106 Finance and Leasing Association

107 M&G Investments

108 Northumberland County Council

109 The new economics foundation (nef)

110 Financial Leeds

111 Northern Film and Media

112 Business Voice West Midlands

113 Octopus Ventures

114 Experian UK & Ireland

115 The Share Centre Limited

116 London Chamber of Commerce and Industry

117 Northamptonshire Enterprise Ltd

118 North West Development Agency

119 Association of Convenience Stores (ACS)

120 ONE North East

121 Peninsula Enterprise

122 The Capital Spillway Trust

123 Institute of Chartered Accountants in England & Wales (ICAEW)

124 South West Regional Development Agency

125 Engineering Employers Federation (EEF)

126 BioIndustry Association (BIA)

127 British Property Federation

128 County Durham Development Company

129 UK Film Council

130 Alex Driver

131 Centre for Business Research, University of Cambridge

132 Intellect

133 EMB Ltd

134 West Midlands Regional Finance Forum

135 Cambridge Enterprise Limited, University of Cambridge

136 NVM Private Equity Limited

137 British Exporters Association (BExA)

138 Business Angel Networks of the West Midlands

139 Tim Hastings

140 Confederation of British Industry (CBI)

141 John Goodger

142 British Bankers' Association (BBA)

143 3h Partners management consultancy

144 Marwyn Investment Management LLP

145 Beringea LLP

146 St John's Innovation Centre

147 Film Export UK

148 British Business Angels Association

149 Charles Breese

150 Finance South East

151 Co-operatives UK

152 Brian Basham

153 Community Development Finance Association (CDFA)

154 National Endowment for Science, Technology and the Arts (NESTA)

155 Santander UK plc

156 Straight Business Solutions

157 Yorkshire Forward

158 British Chambers of Commerce

159 Enterprise Investment Scheme Association (EISA)

160 Asset Based Finance Association

161 London Stock Exchange

162 Institute for Family Business

163 British Business Angels Association

164 Seraphim Capital

165 Nick Pelling

166 British Vehicle Renting and Leasing Association

167 The Quoted Companies Alliance (QCA)

168 Charlesfield First LLP

169 Association for Financial Markets for Europe (AFME)

170 Barclays

171 Greater London Authority (GLA) and London Development Agency (LDA)

172 Capital for Enterprise Limited (CfEL)

173 Institute of Physics

174 Royal Bank of Scotland

175 Welsh Assembly Government

176 Institute of Directors (IoD)

177 Clydesdale Bank

178 Association of Chartered Certified Accountants (ACCA)

179 Institute of Chartered Accountants of Scotland (ICAS) and Scottish Financial Enterprise (SFE)

180 Franchise Development Services

181 Association of British Insurers (ABI)

182 Institute of Directors (IoD) Northern Ireland

183 Aureos Advisors Limited

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