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Using Financial Instruments for SMEs in England in the 2014-2020 Programming Period

A study in support of the ex-ante assessment for the deployment of EU resources

Annex Two – Area Overviews

Yorkshire and the Humber

January 2015

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Version 2	2-02-15	Revised following comments of GDTs

Area Overview: Yorkshire and the Humber

This section provides an overview of the SME finance market in Yorkshire and the Humber, evidence on market failures and the implications for the overall scale and shape of market failures that could reasonably be addressed by future ERDF backed interventions for the 2014-20 programme period. **In order to interpret the overview it is necessary first to review the main ex-ante assessment block one summary report, which outlines the assessment framework which is used**. These sections provide the theoretical basis for the market assessment framework used to assess the finance gap and the portion thereof that is accounted for by market failure.

This section applies this assessment framework to the region and the overall conclusions and implications of this process are summarised at the end of the section. There are various limitations in the published data sets which are used to inform this assessment and various forms of uncertainty, all of which must be borne in mind in interpreting the assessment.

1.1 Economic Geography

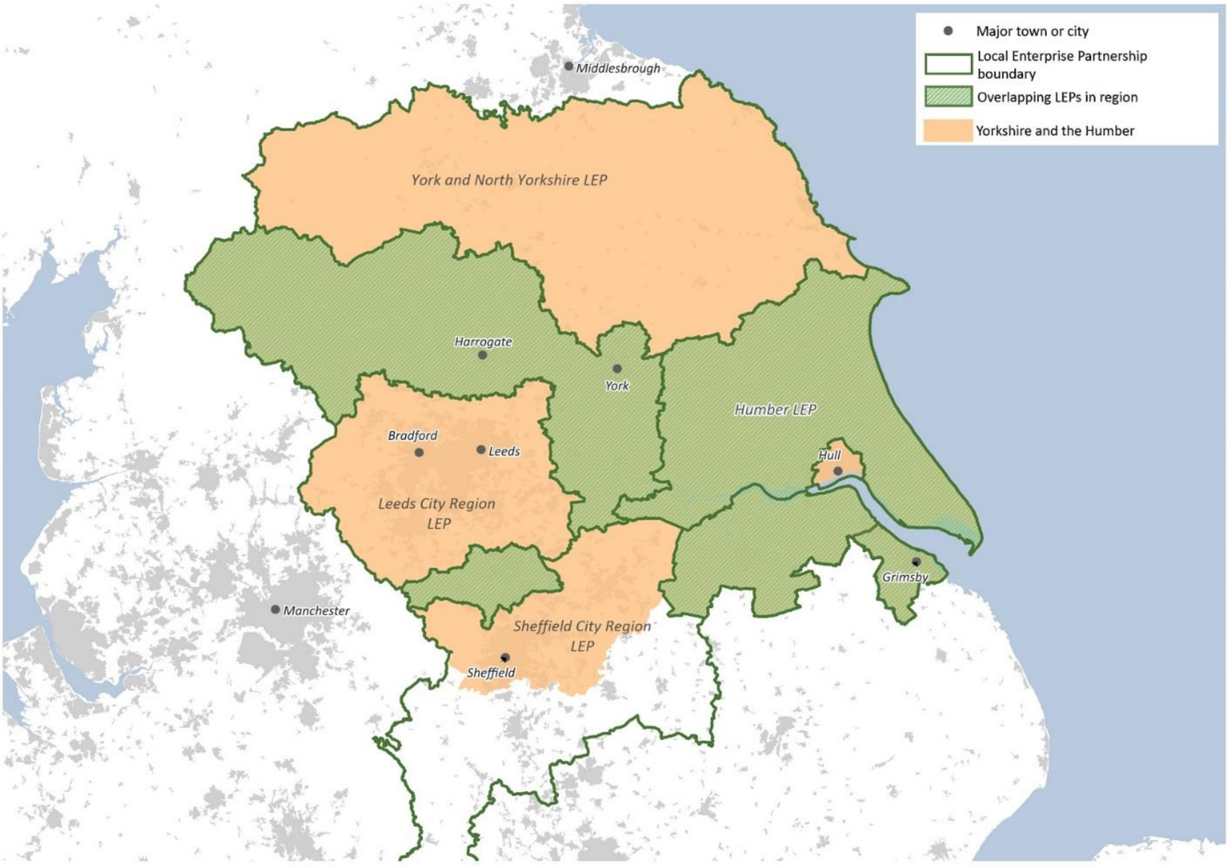
Yorkshire and the Humber is home to 5.3 million residents, 2.3 million jobs, and 353,000 SMEs (90,000 of which have employees).[1] Its total Gross Value Added in 2012 was £93.3 billion, equivalent to £17,600 per head of population, which compares to an England average of £21,900.

Strategic economic development policy in the region is led by four Local Enterprise Partnerships (LEPs):

- Humber LEP, covering Hull, East Riding, North Lincolnshire and North East Lincolnshire.
- Leeds City Region LEP, covering Barnsley, Bradford, Calderdale, Craven, Harrogate, Kirklees, Selby, Wakefield and York.
- Sheffield City Region LEP, covering Barnsley, Bassetlaw, Bolsover, Chesterfield, Derbyshire Dales, Doncaster, North East Derbyshire, Rotherham and Sheffield.
- York, North Yorkshire and East Riding LEP, covering York, North Yorkshire and East Riding.

It should be noted that there are some overlaps between the LEP areas, and that the LEP districts are not exclusively located in Yorkshire and the Humber region.

[1] Source: BIS Population Estimates. Note: This includes sole traders and businesses that are not registered for VAT or PAYE. This data is not available at a sub-regional level.



The Humber LEP area contains 900,000 residents, equivalent to 17% of the total population in the region, and 25,600 enterprises, of which 25,500 are SME employers.[2] It contributes £15 billion in annual GVA. The main economic centre in the LEP area is East Riding, comprising 47% of all enterprises in the LEP area.

There are 3 million residents in the Leeds City Region area, with 86,000 businesses, of which 85,500 are SMEs. Leeds accounts for the greatest proportion of businesses, followed by Bradford and Kirklees. Together they account for 54% of business in the area. Leeds City Region contributes £55 billion in annual GVA, greater than any other LEP area in the region (and just over double the amount of Sheffield City region, the second largest contributor).

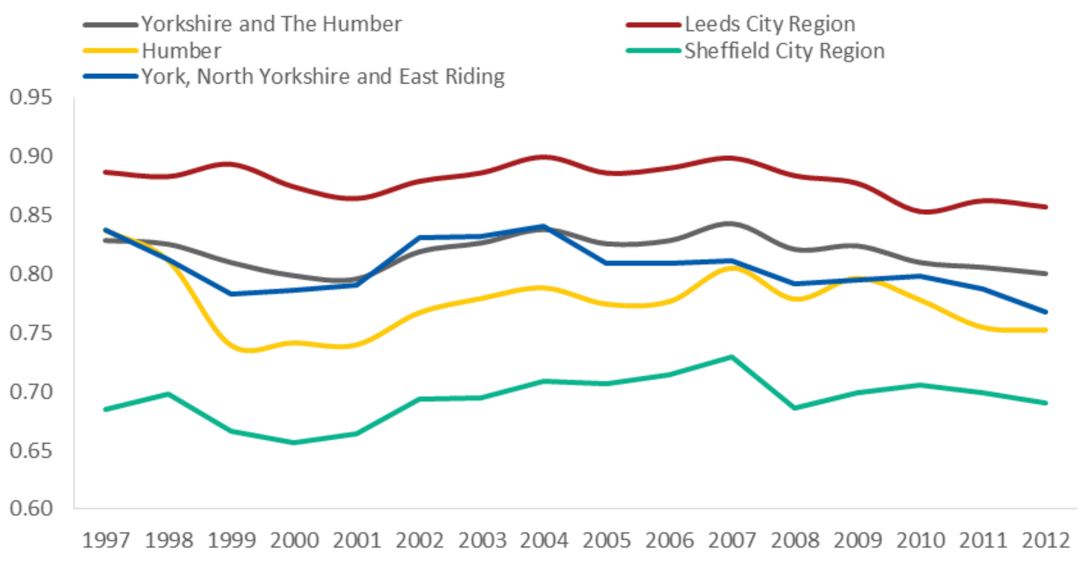
Sheffield City Region contains 1.8 million residents, 45,000 businesses of which 44,700 are SMEs. The LEP area overlaps into the East Midlands (Bassetlaw, Bolsover, Chesterfield, Derbyshire Dales and North East Derbyshire). The city of Sheffield accounts for around 28% of the business base in the LEP area, whilst the whole LEP area contributes £26 billion in annual GVA.

[2] Source: ONS Business Counts. Note that this data source is the only one that can be used to understand the business base at a sub-regional level. It covers both enterprises and local units (which include multiple branches of the same enterprise). Regeneris Consulting have quoted the enterprise figures above. The data also only covers businesses with employees. For these reasons the SME figures quoted at LEP level differ from the regional figures from BIS Population Estimates cited above.

York, North Yorkshire and East Riding LEP contains 1.1 million residents and 47,000 businesses, of which almost all are SMEs. York and East riding account for 38% of businesses in the area, although it should be noted that East Riding is also part of the Humber LEP area. The LEP area contributes £19 billion in annual GVA and is the most rural of the four LEPs.

Gross value added (GVA) per head of population has increased steadily in the region in nominal terms from £10,800 in 1997 to £17,500 in 2012. The GVA per head for the Leeds City Region LEP area has been consistently higher than the rate for both the region and for all other LEPs. GVA per head for Sheffield City Region has been lower than all other areas, and lower than the regional rate throughout the period[3]. GVA per head in the region as of 2012 is around 20% below the England average, or 8% below the England average less London.

Figure 3.1 : *GVA per Head (England=100) - 1997-2012*



Source: Office for National Statistics

1.2 Policy

This section provides a short summary of the main economic development issues in the region and corresponding priorities set out by the LEPs, with specific focus on SME competitiveness and access to finance.

The main economic issues in the area are concerned with the long term transition from an industrial economy to a high value, knowledge intensive mixed economy. A priority for the region is employment, referring to both the number and quality of jobs. SMEs have a role to play here to increase private sector employment and contribute to innovation in priority sectors.

A summary of the key priorities and actions identified by the LEPs, and associated investment, is set out below. There are a number of common themes within this, including the need to support existing,

[3] Note that SCR overlaps into the East Midlands, and so this should be taken into consideration when comparisons are made to the region and other LEPS in the region.

growing businesses, the importance of developing an enterprise culture, support for start-up programmes and focus on SME innovation. This implies that there is a strategic context that would support the provision of finance in all of the segments of the market that is being considered in the assessment. The range of planned business competitiveness interventions may in themselves also serve to stimulate demand for finance. There is a particularly strong emphasis amongst the City Regions and the Humber on innovation and sectoral development, in part with an emphasis on advanced manufacturing and renewables.

Priority Area	Actions identified
Leeds City Region LEP	
Supporting Growing Businesses	• Creating a Business Growth Hub to support SMEs • Continuing to deliver the Business Growth Programme to unlock commercial lending and create jobs • Delivering a start-up programme • Developing flagship innovation assets to deliver business innovation • Export Acceleration programme • Help SMEs make use of digital technologies • Support for JEREMIE Fund as part of a range of finance options. • Focus on innovative manufacturing; financial & professional services; health & life sciences; low carbon & environmental industries; digital & creative industries; and food & drink.
Sheffield City Region LEP	
Ensure new businesses receive the support they need to flourish	• Develop a start-up programme for the area • Embed a culture of enterprise in education system • Provision of appropriate accommodation and facilities • Exploiting knowledge and intellectual assets
Facilitate and proactively support growth amongst existing firms	• Establish Access to Finance Centre of Expertise within Growth Hub • Extend SCR RGF Programme • Assisting businesses to identify and exploit supply chain opportunities. Develop an Innovation Boost programme building on TSB Innovation Vouchers scheme, providing £6k-£10k vouchers. • Encouraging exports through raising awareness of opportunities and addressing barriers
Humber LEP	
Build the growth capabilities of SMEs	• Provide access to finance, including via an RGF Capital Grant Programme Extension • Support to develop business growth strategies, enter new domestic and international markets and implement productivity improvements. • The Humber's SME Growth and Innovation programme • Provide grow-on space where there is a need for it • Importance of renewables
Support an entrepreneurial culture in the Humber	• Provide start-up finance, early stage equity, venture capital and proof of concept funding. • Promote and support entrepreneurship and self-employment, inc. amongst the unemployed • Build on and roll out opportunities for young people to set up in business using existing support mechanisms. • Support businesses to become investment-ready
Increase the level of	• Promote and support research collaboration in priority

innovation amongst local businesses	sectors (inc. support for Computational Sciences Institute at the University of Hull and Platform Initiative, a hub of gaming, digital creativity and content creation industries) • Provision of venture capital and proof of concept funding • Promote and support B2B collaboration on new products and services • New forms of innovation infrastructure and finance e.g. via the Low Carbon Innovation Fund Support for development of SMEs, ICT products, services and e-commerce • Strategic investments in major new technology where there is a case for public funding
York, North Yorkshire and East Riding LEP	
Increase innovation in small businesses	• Create a single access point to improve links between business and universities • Support for HE spin-outs • Financial support for R&D and new product development • Grants, advice and support to SMEs to encourage take-up of low carbon and sustainable technologies
Inspire and support new business starts	• Business start-up support • Enterprise education and culture
Improve business competitiveness	• Simplify and incentivise access to business advice inc. business networks • Tailored business support to meet specific needs, including support for SME growth strategies to enable them to enter new markets • Business friendly planning, regulation and procurement • Awareness-raising activities for supply chain opportunities, and support for accessing them • Access to Finance (including Business Growth Grants for capital investment) • Business Improvement Programme

Source: Strategic Economic Plans and 2014-2020 European Structural and Investment Fund Strategies

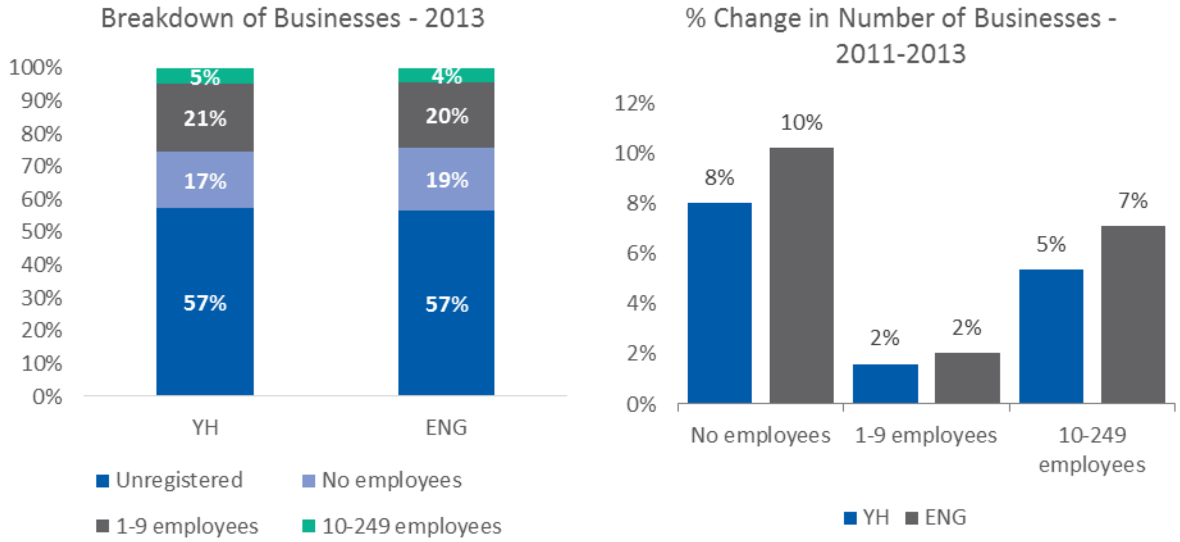
1.3 Business Demography Trends

1.3.1 Business stock

The region is home to 353,200 SMEs, of which 336,200 (95%) are microbusinesses (fewer than 10 employees), 14,500 are small (10-49 employees) and 2,500 are medium sized firms (50-249 employees). Of the microbusiness stock, 203,000 are unregistered for VAT/PAYE and 60,000 are sole traders.

The region has a similar proportion of unregistered businesses to the England average, a smaller proportion of businesses with no employees and slightly greater proportion of small and medium SMEs. In the past three years Yorkshire and the Humber has experienced growth in all size bands of SMEs, with the largest growth in microbusinesses of 8%. However, the rate of change of this growth for all these broad size bands has been less than that of the England.

Figure 3.2: Composition (%) of SME Stock in 2013 and change 2011-2013



Source: BIS Business Population Estimates 2011-2013

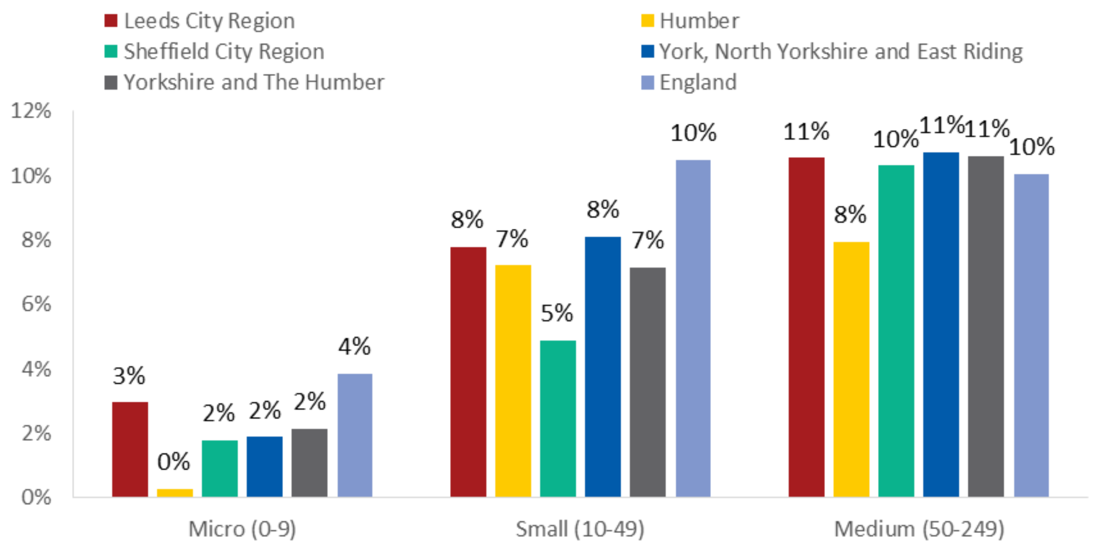
There are around 85,500 SMEs in the Leeds City Region LEP area, more than in any other LEP area in the region. York, North Yorkshire and East Riding LEP area and Sheffield City Region LEP area have a similar number of SMEs (47,000 and 45,00 respectively) compared to Humber LEP which has 25,500 SMEs, the lowest in the region.[4] The composition of SMEs by size band in each area are similar; 86-87% are microbusinesses, 11% are small firms and 2% are medium sized businesses. However Yorkshire, North Yorkshire and East Riding LEP area has a slightly higher proportion of micro-businesses (89%) reflecting its extensive rural economy.

Overall in the region, SME business density is below the national average; it is 18% below the England average (and 15% below excluding London). At a LEP level, York, North Yorkshire and East Riding LEP actually has an SME business density higher than the England average, 24% higher again linked to its rural economy (rising to 29% when London is removed from the England average).For Humber LEP and Leeds City region LEP it is 18% and 17% below the England average, whereas for Sheffield City region it is 28% lower than the national average. There is some, of course, variation by local authority with the highest SME density in North Yorkshire, 46% higher than the England average (52% when London is removed). SME Business density is lowest in Barnsley and Doncaster, lower than both the regional rate (25% lower) and the national rate (38% lower).

For micro and small businesses, growth in the region between 2011 and 2013 has been lower than the national growth rate, however for medium sized businesses it is slightly higher. Growth has been highest in the Leeds City Region LEP, with higher than regional average growth in both micro and small businesses, and in line with the regional growth rate for medium sized businesses. Sheffield City Region LEP has lower than regional average growth rate in all sidebands.

[4] Source: ONS Business counts data

Figure 3.3: % Change in Number of Businesses 2011-2013



Source: ONS Business Counts

The majority of microbusinesses in Yorkshire and the Humber are in the construction sector and the professional, scientific and technical sector. There are variations by LEP area; in York, North Yorkshire and East Riding LEP there is a high concentration of microbusinesses operating in the agriculture, forestry, and fishing sector, whereas Leeds City Region has a high concentration of microbusiness operating in the retail and professional, scientific and technical sector. For the rest of the SME stock, there is little variation in sectors, although manufacturing, accommodation and food services, and the health sector have a slightly higher concentration of businesses in the region.

In terms of the key sectors in the region, each of the LEPs have outlined priority sectors in which they anticipate future growth:

- Leeds City Region LEP has identified the following priority sectors where there is opportunity for growth: the financial and professional services (the largest outside of London), health and life sciences, innovative manufacturing, creative and digital, food and drink, and low carbon and the environmental sector.

- Sheffield City Region LEP is a more diverse economy and so no single dominant sector has been identified to drive future growth. In terms of employment growth, the highest growth is expected to occur in transport and logistics, sport, leisure and tourism, and financial and professional services. Lower employment growth is expected in creative and digital industries, low carbon technology and advanced manufacturing although these are forecasted to give higher future growth in terms of GVA per head.

- Humber LEP has identified the renewables sector as a key driver for future growth. Other key sectors identified are ports and logistics, chemicals, engineering and manufacturing, creative and digital, food and the visitor economy. Looking further ahead, the environmental technologies sector and eco-construction have been outlined as potential key sectors.

- Food manufacturing, agri-tech and bio-renewables are already key sectors in York, North Yorkshire and East Riding LEP and these have been identified as the priority sectors for continued future growth.

1.3.2 Business Starts

In 2012 around 18,000 new businesses formed in the region. At 53 per 10,000 working age adults, this is 24% below the England average, or 13% below the national average once London is removed.

The vast majority of these new businesses were formed in the Leeds City Region LEP, but when adjusted for the working age population the start-up rate is higher in York, North Yorkshire and East Riding LEP. Rates are below the England average in all of the LEPs in the region, but there is mixed performance in the local authorities. North East Lincolnshire and Harrogate have start-up rates that are greater than the England average (7% and 26% respectively) although this may reflect very different economic drivers between these two areas, whereas Hull has a rate 43% below the England average.

The volume of business start-ups has increased by 6% between 2009 and 2012. In York, North Yorkshire and East Riding LEP the growth rate has been highest of all LEPs and higher than the regional rate. In Humber LEP there has actually been a fall in the volume of start-ups.

Table 3.1: Business Starts in Yorkshire and the Humber and its LEP Areas, 2009-12

		Business Starts			Business Starts per 10,000 WAP (2012)	
	2009	**2012**	**Abs Change**		**Number**	**England =100**
Humber LEP	3,155	3,050	-105	-3%	52.5	75
Leeds City Region LEP	9,890	10,515	625	6%	55.0	79
Sheffield City Region LEP	5,085	5,375	290	6%	46.3	66
York, North Yorks, and East Riding LEP	3,985	4,295	310	8%	60.7	87
Yorkshire and the Humber	**17,005**	17,990	985	6%	52.9	76

Source: ONS Business Demography

1.3.3 High growth firms

Given the difficulties in defining and measuring high growth firms, there is little data available. However, the Business Growth Fund has commissioned research on high growth firms, using data from Experian UK based on company accounts. It defines high growth firms as those that have revenues of between £2.5m and £100m, and have had 33% increase in turnover over three years, as well as 10% year-on-year growth for a minimum of two of these years.

The latest report found that 23% of businesses with a turnover between £2.5 million and £100 million in the region fall into this high growth category. This gave the region the highest rank of all the regions (although it represents a fall in the proportion compared to the previous year). However, the region has remained consistently above the England average, and is 1 percentage point higher in the latest year.

Table 3.2: High Growth Firms as a % of all Businesses, 2011-13

	2011 Population of High Growth Firms	Regional Rank (2013)	2011	2012	2013
Yorkshire and the Humber	269	1st	17.8%	24.7%	23.0%
England	4,044		16.9%	20.9%	22.0%

Source: BGF Growth Companies Barometer

1.3.4 Innovation activity

In Yorkshire and the Humber there are approximately 7,500 enterprises defined as innovation active, representing 43% of the business base with at least 10 employees in the region. This is a little below the UK average rate of 44%, and given the relative lack of variation across regions, puts the region 7th of the 9 English regions.

R&D expenditure, in particular, that related to the private and university sectors is one driver of the spin-out and creation of companies and the demand for early stage risk finance. Expenditure on research and development has increased significantly from 2001 to 2012, from £695 million to £1.2 billion which represents an increase of 67% and is the second highest of all increases compared to other regions in England. However in absolute terms this expenditure is the second lowest of all regions. Expenditure per head of the population is also the second lowest of all regions.

There have been around 100 university spinouts in Yorkshire since the year 2000, representing 11% of all spinouts in the UK. This was the fourth highest number of spin outs of all regions, and the third highest (after the North East and London) of all regions when compared to the working age population. The Universities of Sheffield and York accounted for the majority of these spin outs over the period, reflecting their strong track record in the commercialisation of research and IP and proactive approaches to seed and early stage funding.

1.3.5 Enterprise indices

Alongside the data on start-up rates presented earlier, a number of indices provide an insight into the enterprise performance and conditions in the region.

The Global Entrepreneurship Monitor (GEM) provides frequent updates on the scale of early stage business activity, based on a survey of adults. Total Entrepreneurial Activity (TEA) measures the proportion of the working age population that is in the process of setting up a business or involved in a business which has been operational for less than 42 months (three and a half years). It is a commonly used indicator for assessing the extent of early stage commercial activity in an economy.

Using pooled data for 2008-13 at a regional level[5] suggests that Yorkshire and the Humber ranked 4th out of the 9 English regions on its TEA rate. Its performance on the various indicators is mixed, with performance above the UK average in terms of the percentage of adults involved in new (less than 12 months old) and established (trading for up to 42 months) firms but below on the other indicators.

[5] Pooling was necessary due to sample sizes at a regional level.

Table 3.1: Measures of Entrepreneurial Activity, 2008-13

Highlighted cells shows above average results	TEA	% of Opportunity E'preneurs	Stages of E'preneurial Activity				High Growth E'preneurial Aspiration[6]	
			Intend to Start-up in Next 3 yrs	Nascent E'preneurs	New Firms	Est. Firms	All TEA	Est. Firms
London	8.2%	6.6%	8.2%	4.2%	3.8%	5.3%	22.8%	6.3%
East of England	7.6%	6.2%	4.4%	3.8%	3.7%	6.1%	16.0%	5.7%
South East	6.9%	5.5%	5.3%	3.1%	3.6%	7.6%	19.0%	4.2%
South West	6.9%	5.4%	4.6%	3.1%	3.4%	7.5%	9.6%	2.5%
Yorkshire & Humber	6.9%	4.8%	4.4%	2.9%	3.8%	6.2%	10.8%	3.5%
North West	5.9%	4.3%	4.0%	3.0%	2.8%	5.7%	14.4%	5.0%
West Midlands	5.9%	4.2%	6.0%	2.7%	3.1%	5.6%	16.5%	5.1%
North East	5.8%	4.6%	4.0%	2.8%	2.8%	4.2%	10.8%	3.6%
East Midlands	5.2%	3.8%	5.3%	2.5%	2.6%	5.9%	14.7%	2.0%

Source: Global Entrepreneurship Monitor 2008-2013, bespoke regional analysis.

The Santander Enterprise Index is an annual ranking of "the UK's regional entrepreneurial ecosystems." It uses a methodology developed by the Global Entrepreneurship and Development Institute (GEDI) to create an index for each of the UK regions, examining performance against 15 pillars of entrepreneurship. The index uses survey data on people's attitudes, abilities and aspirations with regard to enterprise and then weights these against objective measures of socio-economic infrastructure (broadband connectivity and transport links to other markets) which provide an enabling environment for enterprise.

The latest ranking for 2014 supports the finding of GEM, with the region performing relatively poorly compared to other English regions, although it ranks within the top 40 of the 125 EU regions considered. The analysis suggests that important factors driving Yorkshire and the Humber's score on the index revolve around its performance on indices of attitude, abilities and aspiration. In particular, the region scores 45.4 on aspiration, which compares to 77.7 in London (the top performing region) and 49.0 in the North West (ranking 5th out of the English regions). The report emphasises that a lack of entrepreneurial aspiration serves as a "bottleneck factor" preventing UK regions from realising their full economic potential.

Of course, these regional indices mask the variation within the region and the presence of more dynamic areas such as Leeds and Sheffield.

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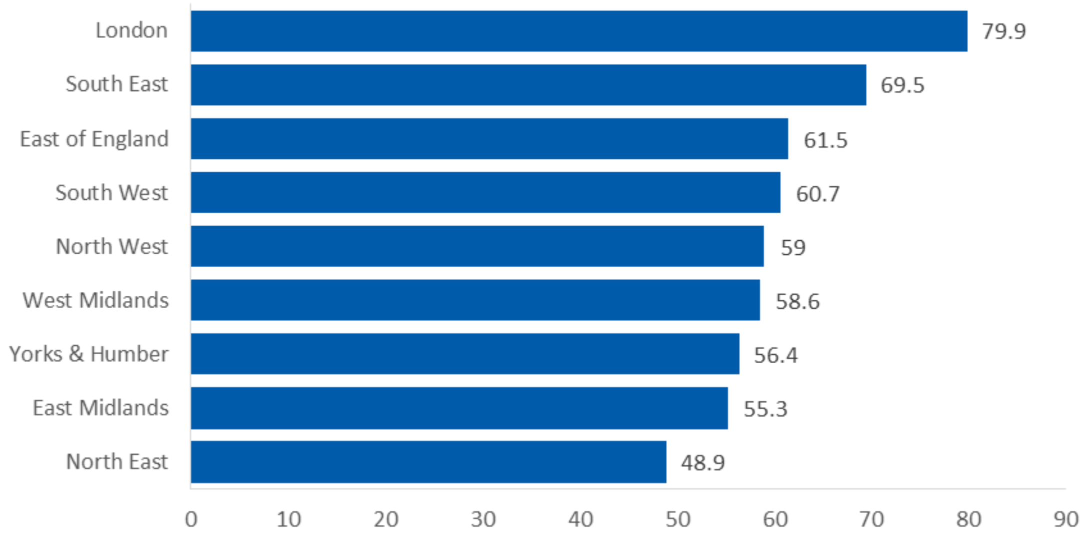
[6] % of firms looking to create 10 jobs and employment growth over 50% in the next five years.

Figure 3.4: Santander Enterprise Index Score - 2014



Source: Santander Enterprise Index 2014

1.4 Demand for and Take-up of External Finance

1.4.1 Survey evidence

As was set out in the main market assessment section of the report, the BIS Small Business Survey provides insights for the UK as a whole on the demand for different types of finance by region, but unfortunately it is not available regionally. The SME Finance Monitor – set up by the Business Finance Taskforce in 2010 - does provide some insight into the demand for finance from SMEs in the regions and the extent to which they are successful in obtaining the finance they are looking for. This only covers debt finance, so in looking at equity finance it is only possible to infer messages from the national SBS survey evidence. Also data is not available sub-regionally, although consultations were undertaken with business and financial sector representatives.

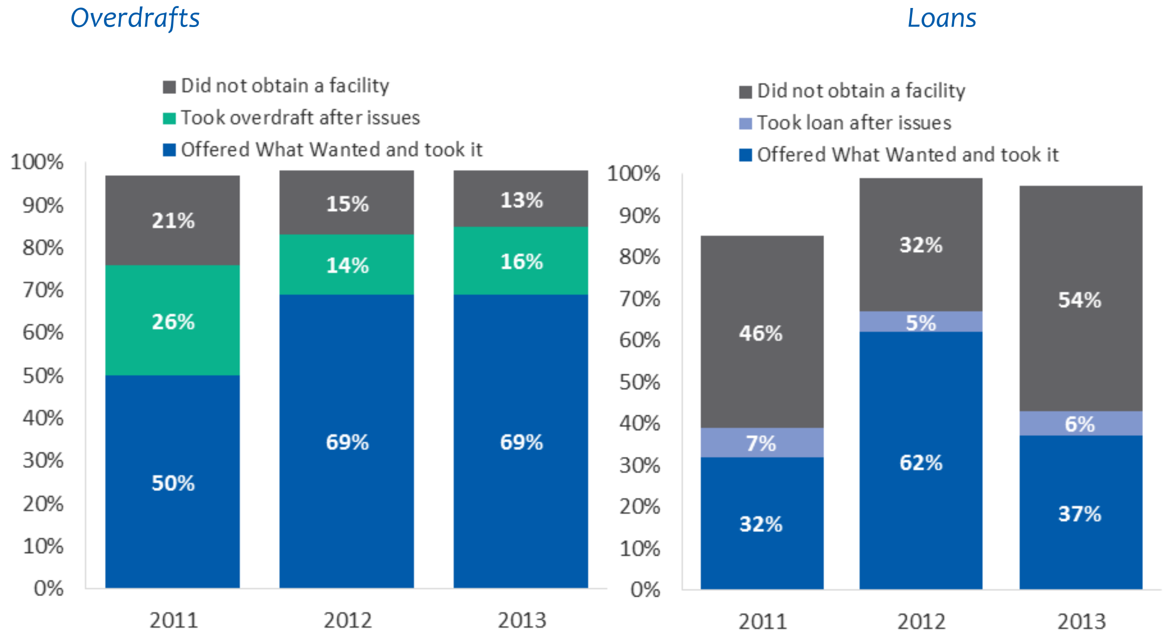
35% of SMEs surveyed in Yorkshire and the Humber in 2013 had used finance of some sort[7] in the past five years, whilst 60% had not used finance at all over this period. 27% had used either an overdraft, loan or credit card. 44% of all SMEs were classed as a "permanent non-borrower" (PNB), meaning that they have not used external finance in the last five years and have not attempted to borrow over the past 12 months, and have no inclination to borrow in the next three months. This PNB proportion has increased since 2011, in-line with the overall trend for the UK. SMEs in Yorkshire and the Humber are statistically significantly less likely to be a PNB than those in other UK regions.

7% of SMEs applied for a new overdraft or loan facility or sought to renew an existing facility. Between 2011 and 2013 success rates for overdrafts have been stable in Yorkshire and the Humber, with 69% of applicants offered the facility that they wanted and subsequently taking it. The latest data for loans shows that 47% of those seeking one were unable to obtain one, a rise on previous years. It should be

[7] Bank overdraft, Credit cards, Bank loan/Commercial mortgage (these three form the core product category), Leasing or hire purchase, Loans/equity from directors, Loans/equity from family and friends, Invoice finance, Grants, Loans from other 3rd parties, Export/import finance.

noted that for both overdrafts and loans the survey reports that there were statistically significant differences in success rates between Yorkshire and the Humber and the UK as a whole.

Figure 3.5: Overdraft and Loan Applications in Yorkshire and the Humber - 2011-2013



Source: SME Finance Monitor 2011-2013.

Notes:1) data for 2013 has small sample sizes and so should be treated with caution 2) the residual proportion is "took another form of financing"

The regional data only covers debt finance, so in looking at equity finance it is only possible to assess at the national level. The only data provided in the BIS SBS is on the proportion of SMEs that were looking for equity investment. This highlights that only a small proportion actively seek out this type of finance, and that this has remained stable over time (standing at 2% in 2012, 2010 and 2008). Less than 1% were seeking mezzanine finance. This partly reflects the more niche nature of equity and mezzanine finance but also probably illustrates the lack of awareness amongst SMEs of this type of finance. The latest survey also shows an emerging awareness of alternative sources, including 1% who are aware of peer to peer/crowdfunding.

Unfortunately the survey evidence does not allow a separate review of the extent to which SMEs seeking this type of finance were successful in obtaining it. We are not aware of any regional level surveys of SMEs on this issue, however the perception of Finance Yorkshire is that SMEs in the region are in general reluctant to seek equity finance if there are other alternative financing routes available to them. Whilst Finance Yorkshire's equity sub-fund has been successful, the level of demand has been less than originally proposed and the fund was subsequently resized.

1.4.2 Theoretical Unmet demand

Unfortunately, whilst the BIS SBS survey provides data that can be used to assess the extent of unmet demand from SMEs, this data is not available for the regions. However, the results of the UK level survey can applied to the Yorkshire and the Humber business base to provide indications of the number of SMEs of different sizes that may be struggling to obtain the finance they are looking for, and hence the value of unmet demand. The important caveats attached to this analysis are presented at the end of this section.

The analysis indicates that, assuming the experience of SMEs in the region is similar to those in the UK as a whole:

- In 2012 there were around 21,600 SMEs in the region looking for external finance, of which 16,200 were microbusinesses. Some of these microbusinesses will have been seeking microfinance; others will have been looking for larger amounts.
- Of these, around 10,000 had difficulties of some sort in obtaining this finance
- 6,900 SMEs obtained none of the finance they were looking for, and 1,300 received some, but not all of what they were seeking (the national data indicates that the likelihood of successfully obtaining finance varies directly with business size).
- 4,700 SMEs had a need for finance did not apply, for the reason that they thought they would be rejected (there is no further detail available from the survey on why they thought they would be rejected).

Table 3.2: Illustrative Analysis of SMEs' Experience in Accessing Finance in Yorkshire and the Humber, using Survey Data

	Total	Looking for finance	Had difficulties	Unable to obtain any finance	Obtained some, but not all finance	Discouraged from applying because thought would be rejected
Micros (1-9)	73,400	16,200	8,100	5,700	1,000	4,100
Small (10-49)	14,500	4,600	1,800	1,200	200	500
Medium (50-249)	2,500	900	200	100	50	50
All SMEs (with employees)	**90,400**	**21,600**	**10,100**	**6,900**	**1,300**	**4,700**

Source: Regeneris Consulting calculations, using data from BIS Small Business Survey 2012 and BIS Business Population Estimates for 2013.
Note: Figure are rounded so may not sum to the totals.

It is then possible to use data on the amount of finance being sought by businesses of different sizes to generate **indicative estimates** on the scale of unmet demand. This analysis shows that total unmet demand in the region could be of the order of £1.4 billion in one year. That is, applying the survey evidence shows that those SMEs that were unsuccessful in obtaining the finance they were looking for were collectively seeking £1.4 billion in external funding. Table 1.5 illustrates how this total breaks down by different sizes of SME. For example, amongst small businesses (10-49 employees), there were £420 million worth of unfunded investment propositions.

It is not possible to determine from this type of analysis how much of this unmet demand is from SMEs that had viable business plans (i.e. those that, as a class of firms, could be supported in such a way that the financial and economic returns to the public sector from doing so would represent value for money, and hence constitutes a market failure). However, Regeneris Consulting have set out in table 3.5 below scenarios on the proportion of firms that might have been viable to illustrate the potential scale of market failure. For example, if 10% of unmet demand was for funding for propositions that would have proved viable, this would imply a finance gap of £4 million for microfinance (defined as up to £25k in this instance) and c.£140 million for larger amounts of finance per year. It should be noted that this is, in effect, the **gap over and above** that what is already being addressed by JEREMIE and other public sector backed initiatives. The survey implies that this unmet demand has grown over time, although this is, of course, based on national rather than regional data.

The survey does not provide data that allows the split the unmet demand for larger amounts of finance between debt and equity finance. The SBS Survey reports that around 2% of SMEs overall are looking for equity finance. However, this does not necessarily accurately represent the proportion (of SMEs or deal values) that are best suited to equity finance, given the nature of their investment projects. Data presented by the British Business Bank suggests that around 4% of the value of finance to SMEs is in the form of equity.

Using SBS data which allows for the size of the SME and variations in the amount of finance sought by type of finance, around 8% of this overall unmet demand is likely to be accounted by equity finance (and 82% by debt finance and a further 10% by other forms of finance). This would imply a total unmet demand of around £110 million per annum for equity (£11 million if 10% of propositions were viable) and £1,180 million for debt (£118 million if 10% of propositions are viable), **in addition to that which is already being met by publicly backed initiatives (see Table 3.10 below for details of many of these initiatives).**

Table 3.3: Illustrative Analysis of Unmet Demand (£millions) for Finance from SMEs in Yorkshire, using Survey Data 2012/13

	Micros (1-9)		Small (10-49)	Medium (50-49)	All SMEs
	Seeking microfinance (up to £25k)	Seeking larger amounts			
- those that obtained none of the finance they were looking for	£40	£680	£400	£240	**£1,360**
- those that obtained some, but not all, of the finance they were looking for*	£2	£30	£20	£30	**£80**
Total unmet demand	**£40**	**£710**	**£420**	**£260**	**£1,430**
Scenarios for % that are viable					
10%	£4	£70	£40	£30	**£140**
20%	£8	£140	£80	£50	**£290**
30%	£11	£210	£130	£80	**£430**
40%	£15	£280	£170	£110	**£570**

** Assumes that these firms obtained 75% of what they were looking for.*
Source: Regeneris Consulting calculations, using data from BIS Small Business Survey 2012 and BIS Business Population Estimates for 2013.
Note: Figures are rounded so may not sum to totals.

This analysis does not cover the latent demand from discouraged SMEs. It is not possible to know how many of those that did not apply due to the expectation of rejection would have had viable business plans. However, for illustration purposes, if 10% of these firms were viable and were seeking similar amounts of money to those who did seek finance, this could add £2 million to the annual gap for microbusinesses and £70 million for other SMEs.

In interpreting this analysis a number of caveats must be applied and limitations acknowledged:

- The data is based on a single survey of businesses undertaken in the UK in 2012. Since this is a sample survey the results are subject to sampling error, even at the UK level. Regeneris Consulting have not been able to access any data from the 2014 survey as it will not be published until Spring 2015. Finance market conditions in 2014 will inevitably be different from those in 2012.
- Regeneris Consulting do not know from the survey whether businesses in the Yorkshire and Humber were more or less likely to be successful in obtaining finance than those in the UK as a whole - consequently the differences between regions are explained by differences in the size and structure of the business base rather than the demand for finance.
- Although the survey reveals the proportion of SMEs that seek different types of external finance, it provides only very limited information on the unmet demand for these different types of finance.
- The analysis presented above only covers SMEs with at least one employee – it does not include sole traders or businesses unregistered for VAT/PAYE. Regeneris Consulting do not have any data on these businesses' experiences of seeking finance, but they account for 74% of all SMEs in the region. Including this could increase the finance gap, although the vast majority of these will have more modest finance requirements linked to growth plans.
- Similarly, this does not cover the experiences of early stage, pre-revenue businesses and then the demand for and unmet requirement for seed and start-up funding.

Whilst this analysis points to a very large level of theoretical unmet demand for finance, this calculation needs to be treated with considerable caution and should not be confused or conflated with a sensible investment range within which ERDF backed FIs should be operating, for different parts of the market i.e the types of finance they require. There are very good reasons for this in particular:

- The calculation is based on national survey evidence, which does not provide a robust evidence base in its own right to draw sound conclusions about demand which goes unmet or is met by existing public sector backed schemes
- Experience suggests that much of this unmet demand does not arise due to market failure (as opposed to inadequate business plans), although the evidence about how much is unclear
- If the public sector chooses to use the available ERDF resources to provide finance to SMEs, it needs to do so on the basis of the absolute and comparative economic impacts and value for money it can secure (there are of course other competing demands for the scarce ERDF resources).

1.4.3 Evidence of unmet demand from existing interventions

In addition to the theoretical exercise above, the experience from existing ERDF and other public sector backed interventions in the SME finance market can provide insight into the level of demand in various segments of the market, including that which is unmet. A detailed discussion on the performance of these initiatives is provided in the analysis of the supply side below. However, here it is worth noting the evidence on demand for the sub-Funds offered:

- Debt: According to the latest quarterly monitoring information for the Business Loans Fund has received a total of 2,174 enquiries, 607 applications and of these 312 have been converted into investments, representing a conversion rate of 51% from applications to investments.
- Early stage: The JEREMIE Seedcorn Fund has received 1,434 enquiries, of which 359 progressed to application and 25 SMEs have received investment. This represents a 7% conversion rate. Whilst some of the applicants are directed to other more suitable forms of finance, many of these propositions are judged to be not suitable for seed funding or too risky.

- Expansion equity: The JEREMIE equity-linked Fund has had 965 enquiries, with 194 applications and 44 SMEs invested in (a 23% investment rate).

In addition the Yorkshire Content Fund had 52 applications as of October 2014, of which 26 had been approved.

Note that Regeneris Consulting do not have any data on conversion rates for the other ERDF backed interventions in the region (for example, the CDFI interventions). However, Regeneris Consulting do have other monitoring data, which is analysed later in this section.

An overall summary of the demand indicators examined above is provided here.

Table 3.4: Summary of Key SME Finance Demand Indicators in Yorkshire and the Humber

Microbusinesses and start-ups	• 336,000 microbusinesses in region (including 60,000 zero employees and 203,000 unregistered businesses) • Some growth in micro stock -> necessity entrepreneurs • Start-up rate 24% below UK avg (13% below UK less London), but business starts growing • Mixed performance in region on enterprise indices (GEM, Santander Enterprise Index) • Total theoretical unmet demand of £40 million per annum in addition to that which is served by existing interventions, or £4 million if 10% were viable)
Early stage businesses	• Region has proportionally fewer product and process innovators than UK avg… • …but performs very well on spin-outs (rank 3rd of English regions) • University of Sheffield and York account for majority of spin-outs • Evidence points to excess demand for JEREMIE Seed corn (conversion rate 7%), although many of these will not be viable
Established SMEs[8]	• 17,000 established SMEs (10-249 employees) • 23% of YH firms with t/o £2.5m-£100m defined as *high growth (Eng = 22%)* • Theoretical unmet demand of £140 million per annum amongst established SMEs for various forms of finance including small and larger loans and equity, which is in addition to that already being addressed by existing interventions; this is equivalent of £14 million per annum assuming 10% of total unmet demand is viable

Source: Various

[8] Regeneris Consulting would caveat that defining an established SME as one with 10 or more employees is one of several possible ways of defining established SMEs as distinct from microbusinesses and early stage ventures. Others could include using the age of the business. However, there is a lack of data available to do this.

1.5 Supply of External Finance

1.5.1 Trends in supply

The key trends in the supply of finance are summarised below by market segment, using publicly available data. In the discussion of supply reference is made to the performance of the current JEREMIE Fund and other publicly backed instruments where this is available. Since the Finance Yorkshire has been operating in various segments of the SME finance market in the region for a number of years, and given the limitations to the publicly available data, the experience offers useful insights into the SME finance market and its drivers. This draws on the latest available performance data, insights from the mid-term evaluation, and the consultations.

Following this review of the market Regeneris Consulting then review the role of other important ERDF and other public sector backed financial interventions (including for example, the Yorkshire Content Fund and the Key Fund-led CDFI interventions) in the region.

A summary table of the relevant sources of supply is provided at the end of this section.

1.5.1.1 Debt

As noted in the main market assessment, there has been an unprecedented shift in the landscape for bank debt for SMEs in the UK, with a vast reduction in the availability of credit following the financial crisis as banks have been rebuilding balance sheets. Although the precise dynamics vary from one bank to another, and some are more active in lending than others, to a large extent these trends are national (or indeed international) in scope, and hence affect SMEs in all of the English regions.

Nonetheless, it is worth briefly reviewing the available regional data. Sub-national data on bank debt was not available until the Business Finance Taskforce started to record lending to SMEs from Q3 2011. So whilst this data does not reveal anything about the period before this it does indicate the more recent trend.

The total value of overdrafts held by SMEs in the region fell between Q3 2011 and Q2 2014 from £1.04bn to £0.9bn (-13%), albeit by a smaller proportion than in the UK as a whole (-20%). This fall was felt particularly by small businesses[9] (a 23% fall) and a lesser extent by medium sized businesses (a 3% fall). This is consistent with messages from consultations and the wider national trends, as for other regions, banks' use of asset-based facilities such as invoice discounting (not captured in the data below or in any regional data) has increased marginally.

In contrast to the UK as a whole the total stock of loans held by SMEs in the region increased marginally 1.1% to £6.27billion, compared to a 3% fall across the UK. However, again small businesses saw a fall (of 2%). This is consistent with data on the number of new loan facilities approved for small businesses, which fell by 13% over the period.

[9] Defined here by the BBA as businesses with annual debit turnover of less than £2 million.

These messages are supported by the consultations undertaken with finance providers and SME advisors in the region, which confirm the tightening of bank lending after the financial crisis, especially in particular sectors to which banks wished to reduce their exposure and for SMEs that lack assets (and have seen the value of any assets fall).

The experience of the current regional JEREMIE initiative also helps to illuminate the trends in debt markets for SMEs. The Fund was originally set at £27 million, offering loans of up to £150k. It became evident that the Fund was experiencing excess demand, including for larger loans, in part as a consequence of the environment for bank lending. As a consequence (and given the performance of the equity linked Fund – see below), £5 million was moved from the equity-linked fund to the debt fund and this funding could be used for loans of up to £250k.

Table 3.5: Selected Key Performance Data for JEREMIE Loan Fund, at June 2014

	Investment (£000s)	Conversion rate	Provision rate*	Total Value Ratio	Average investment (£000s)	Private Sector Leverage (£000s)	Jobs Created
Actual	27,652	51%	6%	93.4%	89	88	3,127
Target to date	27,349	-	13%	-	75	96	2,111
% of target	101%			-	118%	91%	148%

Source: Finance Yorkshire Quarterly Information Digest April-June 2014

Note: The provision rate is a composite measure taking into account actual write offs and specific provisions. The target provision rate to date refers to the EIB maximum. Total Value Ratio refers to the net book value of investments made plus actual cash returns, divided by the amount invested

Performance data from the Fund[10] supports the conclusion that there has been a significant gap in the provision of debt to SMEs in general and that this represents a market failure:

- Conversion rates have been high, indicating the strength of the propositions coming forward
- Default rates are low and well below the EIB provision rate
- Significant private sector leverage has been attracted to these deals (although a little below the target)
- There has been strong performance against economic outputs – for example, over 3,100 jobs have been created to date, against the target to that point of 2,100.

Focussing on the micro end of the SME debt space, the latest monitoring data shows that 62% of loans made to end of June 2014 were in the £15-50k range, suggesting strong demand for this size of loans.

The UK Government has been active in trying to stimulate the flow of lending to SMEs in recent years, increasingly coordinated through the British Business Bank. The main initiatives have included:

[10] This is based on data presented in the Quarterly Report for the Fund at end of June 2014.

- Funding for Lending: As elsewhere the message from consultations appears to have been that Funding for Lending has not had any noticeable impact on the supply of debt to SMEs.[11] The scheme was recently refocused on businesses only – it has yet to be seen what impact the scheme will have on SME lending.
- Enterprise Finance Guarantee (EfG). Data on the EfG suggests a reasonably strong take up of the scheme in Yorkshire and the Humber to date. The value of EfG-backed loans in the region equates to around £30 million per annum on average over the period. The average value of loan backed by the scheme in the region is around £92k, showing that the scheme has been focussed on smaller amounts of debt, but at somewhat higher levels than what would constitute a microloan.
- The Business Finance Partnership and the British Business Bank Investment Programme provide funding to non-bank channels to invest in small and medium sized businesses.[12] The data suggests a strong penetration in the region to date. A total of £200m has been invested in the region, which is equivalent to an annual average of £73 million. The average value of investment was 170k, which compares to the England average of £200k. This is equivalent to £800 per SME in the region, which is above the England average of £500.
- The start-up loans initiative, set up in 2012 to help 18-30 year olds and later extended to all ages, has had some impact in the region in providing small amounts of debt to start ups. The latest statistics show that £9.9 million has been invested in Yorkshire and the Humber (around £3.5 million per year on average, with an average value of £5k). This represents £39 per SME employer, compared to £70 in England as a whole.

Alternative sources of debt funding have had a role to play in getting debt out to SMEs in the region. The rise of debt-based alternative sources in the UK is well documented, with the latest review of the sector estimating that Peer-to-Peer business lending in the UK has increased to £193 million in 2013, and predicted to grow to £750m in 2014.[13] This may be playing a role in filling gaps at the lower end of the SME debt market, with the average size of loan raised in the UK being £73,000 in 2013 and 33% of borrowers believing they would be unlikely to get funds from elsewhere. There is no regional data on P2P business lending by region, but evidence from the consultations suggests it has played a role. Finance Yorkshire reports that P2P lenders have been a growing source of co-investment. Indeed, a new P2P platform (The Funding Club) was launched in November 2014 in the region, targeting property developers as well as other businesses. As set out in the main report, the future role of these sources is unclear.

There are a range of other sources of supply operating in the region. It is outside of the scope of this report to map these out in detail, but the key sources include:

CDFIs:

- Evidence from a review of the CDFI sector nationally in 2010 found a high demand for loan finance from the social enterprise sector in the region, partly due to the move away from grants and also due to the difficulties in accessing such finance from the mainstream (something that has been exacerbated by the financial crisis and general contraction in lending).
- These play a particularly important role in Yorkshire and the Humber. In 2013 the region accounted for 28% of all UK CDFI lending by value and 19% by volume. This was equivalent to 1,700 loans, with a value of £14.6m. According to the CDFA the Business Enterprise Fund (BEF) – operating in West and North Yorkshire - made a strong contribution here. In the Yorkshire and Humber region, the total number of businesses supported increased from 435 to 1,374 between 2011 and 2013. A review the Key Fund (funded by ERDF) is later in this chapter.

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[11] Unfortunately the data on the scheme is not split between lending to businesses and lending to individuals, so it is not possible to verify this using performance data.

[12] The Business Finance Partnership ran until April 2013 and the Investment Programme has superseded it. The Investment Programme makes some money available to equity investors as well as lenders.

[13] NESTA (2014)

Local loan funds:

- For example the Humber LEP runs a Business Loan Fund (funded by the Growing Places Fund - GPF), offering £100k to £1 million to businesses investing in capital projects. Leeds City Region also runs a GPF-funded loan fund (offering loans £500k-£1m) targeted at capital projects. York, North Yorkshire and East Riding runs a business grant scheme offering £5k-£1m grants to businesses and SMEs making capital investments or engaging in R&D.

The ERDF funded component of these projects will be coming to an end in 2015 (or earlier) and the Growing Places Fund financed activity will possibly run for longer depending on the precise arrangements in place. There is the potential for the legacy returns to also be utilised to support on-going activity in the future, but the manner in which these resources are used will be determined locally.

1.5.1.2 Early stage finance

As we noted in the main market assessment, the available data on the supply of early stage finance is limited in so far as much of the investment activity in this area is informal and therefore not wholly captured in published statistics. The available data from the BVCA shows that early stage investment in Yorkshire and the Humber was running at an annual average of £5.8 million between 2007 and 2010, with around 20 companies per annum receiving investment. This then increased to an annual average of £7.7 million between 2011 and 2013. Overall the level of investment per SME is significantly below the England average (see

Table 3.8 at the end of this section).

These figures include the investment made by the JEREMIE Fund, which operates a Seedcorn Fund investing in early stage ventures which are innovative, have potential for IP creation, are beyond the research stage and have potential for rapid growth. The Fund offers up to £780k.

The latest performance data for the Fund again strongly supports a conclusion that there is a significant gap in mainstream provision, and that this represents a market failure:

- The conversion rate is very low, at just 7%. There are, of course, various factors behind this including the viability of the propositions but it does suggest a strong latent demand for finance in this area.
- Default rates are running at a reasonable rate to date given the typical failure rates seen in this area (although this will inevitably increase over time), and hence the total value ratio is reasonable.
- Significant levels of private sector leverage have been secured, well in excess of what was originally envisaged.
- The portfolio is ahead of target on job creation.

Table 3.6 : Selected Key Performance Data for JEREMIE Seedcorn Fund, at June 2014

	Investment (£000s)	Conversion rate	Provision rate	Total Value Ratio	Average investment (£000s)	Private Sector Leverage (£m)	Jobs Created
Actual	13,169	7%	18%	96.1%	£527	49	170
Target to date	13,280	-	30%	-	£442	9	150
% of target	99%				119%	549%	113%

Source: Finance Yorkshire Quarterly Information Digest April-June 2014

Note: The provision rate is a composite measure taking into account actual write offs and specific provisions. Total Value Ratio refers to the net book value of investments made plus actual cash returns, divided by the amount invested

A number of national initiatives have been operating in this area of the market. The key statistics on their impact on the region are provided below:

- **The Angel Co-Fund.** This £100m Fund was launched in November 2011 with a grant from the Regional Growth Fund. The aim has been to invest between £100k and £1 million in high potential businesses, and to leverage significant co-investment from business angels. It invests in both early and later stage businesses. The latest monitoring data indicates that only one £290k investment has been made in the region to date (0.3% of the England total).
- **Enterprise Capital Funds** were originally set up in 2005 as a government-backed scheme with the aim of investing up to £2 million in early stage companies. ECFs operate as private companies that back private capital with Government-guaranteed leverage. The limit on the amount that ECFs could invest into any one fund was £25m, which has recently been increased to £50m. The ECFs are typically UK-wide Funds, although regional funds have been supported – including the NE JEREMIE Fund. For various reasons, two thirds of the value of investment made to date has gone to companies based in the southern regions of England (London, South East and East of England). The latest monitoring data shows that three investments have been made in the region to date, with a value of £2 million (including co-investment). This is well below the region's share of the UK's SMEs.
- **UK Innovation Investment Fund.** This Fund of Funds provides capital for existing venture capital funds, with a total capital of £330 million (of which £150m has come from the UK Government and £180 million has come from the private sector). It is targeted at small businesses with growth potential and new ventures in the digital, life sciences, clean technology and advanced manufacturing sectors. Regional data is not available for this fund.

- **Aspire Fund.** This £12.5m British Business Bank Fund provides equity investment of £100k-£1 million for women-led businesses across the UK, some of which is early stage. £4.7 million has been invested to date in the UK, but no regional data is available.
- **Tax incentives.** Collectively tax incentives are the biggest intervention in the UK equity market by value. The Enterprise Investment Scheme (EIS) provides 30% tax relief for investors making an investment of up to £1m in any tax year. SEIS is a derivative of EIS, which aims to encourage seed investment in early stage companies. Investors receive tax relief of 50% on investments up to £100k and Capital Gains Tax exemption on any gains in SEIS shares. ONS data based on HMRC returns shows that a total of £47 million has been invested through the EIS scheme in Yorkshire and the Humber, in 238 companies, an annual average of £16 million. This is equivalent to £170 per SME employer in the region, which compares to the England average of £650. So whilst the scheme has had an impact in the region, it has stimulated less investment than in other regions.

There are also a range of university-related seed and early stage activities across the region, such as the partnership between the University of York and Fusion IP Group Plc.

Alternative funding sources have also played a role in this market, including equity based crowdfunding platforms. These are much smaller in scale than P2P platforms: the latest review of the UK market found that equity based crowdfunding amounted to £28 million nationally, representing very strong growth from the estimated £4m in 2012 (the average amount of money raised was £199,000). The latest available data suggests that crowdfunding has had little, if any, penetration in the region to date. Reward-based crowdfunding (where individuals donate to fund a project with the expectation of a non-financial reward in the event of its success) has had more of an impact in the region, according to the same report, with 5% of companies using this finance in the UK being based in the region.

Whilst these platforms may play some role in early stage finance in the region, the view – supported by consultations across the country – is that they are very unlikely to serve all of the needs of early stage companies. Some of the consultees have made the point that mechanisms are well suited to project finance but much less well suited to building new, innovative businesses, given the need for a longer term commitment of funds through several rounds of funding and the potential for significant dilution for the initial investors. Further, given that these forms of financing are at an embryonic stage there remains potential for significant levels of write offs to come through from the investments made to date, which would impact on the reputation of the platforms.

1.5.1.3 Expansion equity

The BVCA also publishes data on later stage growth deals completed in the region (privately and publicly backed). According to this data the level of investment in the region has fluctuated considerably in recent years, with a peak of £226m in 2008 and an annual average of £100m between 2007-10 (this falls to £60m, excluding the 2008 figure). In recent years much less has been invested, with an annual average of £40m invested in 14 companies per annum in the period 2011-13 (an average investment value of £2.8 million).

This trend can partly be explained by economic conditions, with business confidence severely hit in the period 2010-12 in particular in the region, as it was nationally. This had a general impact on business investment and especially more risky expansion projects, which can be postponed by businesses whilst they wait for market conditions to improve. More generally, several of the consultees commented that there is a longer term cultural resistance to equity finance in the region, with entrepreneurs often unwilling to give up equity in their business, even if doing so would enhance growth prospects. This will continue to be a challenge for the provision of equity finance in the region.

Again the experience of the current JEREMIE is useful in understanding market conditions and the extent to which there is market failure. The JEREMIE Fund contains an equity-linked Fund, originally set at £48 million. The deterioration of market conditions significantly impacted on the demand for expansion equity finance, and consequently £5m was moved to the business loans Fund.

This is evident from the data on the performance of the Fund, which shows the Fund behind investment target but making up this gap with a higher investment rate more recently. It also highlights the challenge of levering in private money to this area given the risk averse investment climate. However, the Fund is performing well against its job creation target and has made back some ground in recent months.

Table 3.7: Selected Key Performance Data for JEREMIE Equity-Linked Fund, at June 2014

	Investment (£000s)	Conversion rate	Provision rate	Total Value Ratio	Average investment (£000s)	Private Sector Leverage	Jobs Created
Actual	32,183	23%	31%	74.0%	731	12	437
Target to date	38,486	-	33%	-	558	85	312
% of target	84%		95%	-	131%	15%	140%

Source: Finance Yorkshire Quarterly Information Digest April-June 2014

Note: The provision rate is a composite measure taking into account actual write offs and specific provisions. Total Value Ratio refers to the net book value of investments made plus actual cash returns, divided by the amount invested.

Again there are several UK level initiatives in this space.

- **The Business Growth Fund (BGF)** was set up in July 2012 and is backed by a syndicate of banks with £2.5 billion of capital – it focusses on growth equity and mezzanine finance, offering £2m-£10m. It is designed to be an evergreen fund. Data on the current portfolio shows that four investments have been made in the region to date, with an average value of £6.5 million. This supports feedback from consultations suggesting that the Fund is investing at higher levels within the £2m-10m range.
- **Enterprise Capital Funds** can also invest in later stage businesses. The latest monitoring data was presented earlier under the early stage section.

There are other, quasi-public sector equity funds operating in the region, including Coalfield and Steel Industry Funds.

The table below provides a summary of the supply of SME finance in the Yorkshire and Humber region. Although the situation varies between different types of the finance, it is clear from the table that the region receives less finance per SME (and also on other comparable measures) than the average for England. Although the picture is completed by the availability of the data, this difference is more marked for equity base finance than debt.

Table 3.8: Summary of Key Sources of SME Finance Supply in Yorkshire and the Humber

	Average annual value of Investment, 2013 £m	Average value of investment made, £000s (England avg in brackets)	Value per SME, £ (England average in brackets)	% change in value 2011-13 (England avg in brackets)
Debt				
New loans to Small Businesses (BBA data)	£560	£79.7 (£82.2)	£6,200 (£7,300)	-15% (-12%)
New loans to Medium sized businesses (BBA data)	£950	£302 (£295)	£10,500 (£11,300)	-3% (1.5%)
New overdrafts approved for Small Businesses (BBA data)	£203	£15.5 (£15.6)	£2,200 (£2,100)	-28% (-25%)
New overdrafts approved for Medium sized businesses (BBA data)	£233	£87 (£81)	£2,600 (£2,200)	-11% (-5%)
Enterprise Finance Guarantee backed lending (Business Bank data)	£30	£91.7 (£100)	£330 (£340)	NA
Start-up Loans (Business Bank data)	£3.5	£5.1 (£9)	£40 (£70)	NA
Business Finance Partnership & Investment Programme (Business Bank)	£73	£263 (£206)	£800 (£502)	NA
ERDF backed debt (MCIS data)	£16.9	£40.4 (£83)	£87 (£40)	NA
Equity				
Early stage equity investment (BVCA)	£8.3	£481 (£1,081)	£90 (£350)	0% (24%)
Expansion equity investment (BVCA)	£40.3	£2,810 (£4,830)	£445 (£1,150)	-55% (-62%)
Angel Co-Fund (Business Bank data)	£0.1	£290 (£1,830)	£1.1 (£30)	NA
Enterprise Capital Funds (Business Bank data)	£0.26	£690 (£1,340)	£2.9 (£30)	NA
ERDF backed equity (MCIS data)	£15.6	£328 (£399)	£143	NA
Enterprise Investment Scheme (EIS) (HMRC data)	15.6	£197 (£345)	£171 (£650)	-5%
Business Growth Fund	£21.0	£6,500 (£5,600)	£104 (£80)	76%
Equity-based crowdfunding	£0	NA	£0 (£26)	NA
Other crowdfunding (reward-based, donation)	£2.1	NA	£23.5 (£35)	NA

Source: BBA, BVCA, NESTA, HMRC, BGF. Note: a detailed explanation of the sources and coverage of the data is provided in Appendix.

1.5.2 Performance of ERDF backed funds

1.5.2.1 Specific interventions

In addition to JEREMIE there are a number of other ERDF supported Funds operating in the region, addressing various specific aspects of the finance gap:

- **The Yorkshire Content Fund (YCF).** Established in February 2012, this Fund – backed with £15m of ERDF and using a co-investment model - invests in producers in the TV, film, video games and digital sectors who are based in the region or wishing to film or establish a base in the region.
- **The Key Fund.** Originally established in 1998, the Fund provides loans from £5k up to £300k to social enterprises. Two CDFI interventions have been funded by ERDF in the current Programme: the Key Fund for SMEs and Social Enterprises and CDFI Loans for SMEs and Social Enterprises.

Reviewing the performance of these interventions provides further useful insight on the finance gap and market failures in the specific sectors in which they are operating.

The YCF is designed to address two key market failures centring around the lack of availability of finance for projects (a market failure that has been exacerbated by the banks reduction in both unsecured and collateralised lending). It provides funding for content production that would not otherwise take place or would not take place in Yorkshire. The investment in made into the content specifically and is then recouped via the sales of the content in the marketplace.

Headline performance data made available to Regeneris Consulting by DCLG show that the Yorkshire Content Fund is on target in terms of the value of ERDF investment made. It is ahead of target on larger investments (> £500k). Whilst the latest data suggest that it is somewhat behind plan for the smaller investment amounts, a new project was approved subsequently to this in the £100-500k range, and the performance report comments that new projects are imminent up to £100k.

Table 3.9: Investment Performance Data (values in £000s) – Yorkshire Content Fund

	Defrayment			**Actual defrayment plus approvals**		
	Target to end Sept	**Actual to end Sept**	**% of target**	**Actual defrayment plus planned approvals**	**Actual defrayment plus actual approvals**	**% of target**
Total	£8,040	£7,590	94%	£11,272	£10,669	95%
> £500k	£4,556	£4,365	96%	£6,387	£7,345	115%
£100-500k	£3,216	£3,105	97%	£4,509	£3,105	69%
up to £100k	£268	£120	45%	£376	£219	58%

Source: DCLG Quarterly Monitoring Report, end June 2014

The latest data on key economic outputs is set out below:

- Job creation is shown as below target but the progress report indicates that a further output collection exercise for Q2 and Q3 2014 is underway and a large number of freelance jobs have been created that cannot be recorded as outputs under ERDF regulations (there is also significant potential for indirect and induced jobs to be created in the region as a result of the expenditure retained in the region from production. These jobs are not captured in the monitoring data)
- The Fund is well ahead of target on businesses assisted.

Table 3.10 : Key Output Performance Data – Yorkshire Content Fund

	To Date Plan	To Date Forecasted from Contracted Projects (Sep 2014)	To Date Forecasted from Projects approved and in negotiation (Sep 2014)	Contract Target (Actual) (Sep 2014)	To Date Actual (Sep 2014)	To Date KPI% based on contract target (Sep 2014)
Jobs Created	159	145	13.5	117.5	64	55%
Businesses assisted	28	24	4	20	26	130%

Source: DCLG Quarterly Monitoring Report, end June 2014

The Fund also reports that, for every £1 of ERDF invested in the projects, £4.70 is spent locally, supporting the Yorkshire and the Humber economy.

The Fund has drawn up a forecasted legacy from each of its investments, based on the returns expected from successful content productions. It is currently predicting a legacy of £12 million, including projections from future investments (equivalent to 80% of the £15 million ERDF investment). The data indicates that almost £200k has been realised to date.

Regeneris Consulting have not had access to any evaluation evidence but the performance data suggests that the Fund is generally on track and has invested in award winning productions that would not otherwise have come to the region.

The Key Fund offers business loans - sometimes with grants – and sometimes equity to social enterprises in the region, in order to contribute towards relieving poverty and to assist regeneration of deprived communities. It addresses the market failure in funding for social enterprises, funding those which cannot obtain finance from the private sector. To date the Key Fund has invested over £30m in the social enterprise sector and assisted more than 2,100 organisations.

There are two ERDF-supported projects in the region: the Key Fund for SMEs and Social Enterprises, funded with £1.4 million ERDF money (matched by £1.4 million of private funds), and CDFI Loans for SMEs and Social Enterprises, a larger programme delivered by a consortium with £18.8 million of ERDF support (and £18.4 million of private match).

The key performance data made available to Regeneris Consulting on these Funds is presented below. Key points to note are that:

- A combined total of £21.5m has been invested by the two Funds between 2011 and June 2014 (an annual average of around £6 million), of which around half is ERDF funding.
- Collectively a total of 455 jobs have been created, representing good progress against the target of 474 jobs. The Key Fund project has exceeded its job creation target.
- Fewer businesses have been assisted than envisaged by the Key Fund for SMEs and Social Enterprises, implying larger investments than anticipated.

Table 3.11 : Key Performance Data – the Key Fund for SMEs and Social Enterprises

	Total 2011 to December 2013		
	Profile	**Actual**	**% variation**
Investment (total)	-	£2.6	
Investment (ERDF)	£1.4	£1.1	-23%
Businesses assisted	120	38	-68%
Jobs Created	23	50	117%

Source: DCLG Quarterly Monitoring Report, end June 2014

Table 3.12: Key Performance Data – CDFI Loans for SMEs and Social Enterprises

	Total 2011 to end June 2014		
	Profile	Actual	% variation
Investment (total)	-	£18.9	-
Investment (ERDF)	£9.9	£9.5	-5%
Businesses assisted	485	482	-1%
Jobs Created	451	405	-10%

Source: DCLG Quarterly Monitoring Report, end June 2014

According to the monitoring data, the CDFI loans for SMEs and Social Enterprises project has not been given a legacy target, but has recorded realisations of £2.1 million to date. The overall legacy target in the Business Plan for the Key Fund for SMEs and Social Enterprises project was £1.24 million, commencing from January 2014, with a forecast wind up date of 2019. To date, £701k has been realised, suggesting very good progress.

1.5.2.2 General points

More generally, the Yorkshire and Humber region has a strong history of delivering publicly backed finance to SMEs, although this was much more established in South Yorkshire. The 2000-06 ERDF Programme funded two key interventions: the South Yorkshire Investment Fund (SYIF) in the South Yorkshire Objective One area and the Partnership Investment Fund in the Objective Two area. These Funds invested £85 million into SMEs over the period.

The current JEREMIE Fund and other interventions built on this experience and the current interventions have established themselves well in the marketplace, developing links with other finance providers, intermediaries and the SME advisor community. There is therefore a strong platform to build on should partners wish to pursue successor interventions.

Data provided to Regeneris Consulting by DCLG shows that those regional Funds supported under the 2000-06 ERDF Programme have returned a legacy of £16 million ERDF by the time the Funds were wound up. On current projections there was £3 million in ex-RDA Single Programme legacy available and there could be a further £6.1 million returned during the 2014-20 period. There is a further £16 million legacy specific to ERDF funding, plus potentially larger amounts returned in the 2014-10 period. It should be noted that some of this legacy may already have been allocated, and that there are no guarantees that these projections will be realised, given the uncertainty attached to them.

1.6 Implications for Future Public Sector Backed Funds

This section brings together the results of the preceding analysis to draw out the high level implications for future public sector backed SME finance schemes during the 2014-20 programming period in the region. This is done with reference to the area based market assessment framework presented the summary main report. **The final two steps of the framework will be completed as part of the block two element of the ex-ante assessment.**

The assessment against the steps in the framework is provided in the table below and the key conclusions follow on form this.

	Micro-Loans	Early Stage VC	Debt for Growing, Established SMEs	Expansion Equity for Established SMEs
Step 1 - Demand and Supply Characteristics	• 336,000 microbusinesses in YH (including 60,000 sole traders and 203,000 unregistered businesses) • Mixed performance on enterprise indices; start-up rates significantly below the national average • Lack of commercial provision of microloans • Range of schemes (CDFIs, local grant and loan schemes, start-up loans) operating in the region filling some of the gap at lower levels	• Region has fewer product and process innovators than the UK average • But significant number of university spin outs (region ranks 3rd of English regions when compared to W.A. population) • Very little provision of early stage investment outside JEREMIE in region – other players further from market • EIS has had some impact on supply of co-investment, but much less active than England average • Strong leverage effect from presence of JEREMIE Fund managers	• 17,000 established SMEs in the region • National reduction in bank lending has been felt in region – particularly in terms of overdraft provision to small businesses • Reasonably strong take up of EfG in the region, but below England average • Other initiatives (BFP and Investment Programme) appear to have had more impact • P2P lending has had significant growth – impact on the region unclear and remains low in context of overall lending	• 17,000 established SMEs in the region • 21.2% of businesses in region defined as high growth. YH ranks 1st of all English regions • Demand for expansion equity hit by decline in business confidence (reflected in JEREMIE performance) but some signs of recovery • Equity aversion remains a long term cultural issues amongst SME owners in the region • Few mainstream providers, generally focussing on fewer, larger deals (e.g. BGF avg investment of £6.5m)
Step 2 – Unmet Demand	• Strong evidence pointing towards particular, and growing, difficulties experienced by micro-businesses in obtaining finance • Theoretical unmet demand of c.£40m p.a. if only 10% of rejected firms had solid business plans (in addition to the gap being addressed by current JEREMIE and CDFIs)	• Compelling evidence of demand unmet from mainstream sources • Very low conversion rates of JEREMIE Funds suggests significant levels of unmet demand	• National survey data suggests around 40% of small and 30% of medium sized businesses have problems accessing finance, and this has grown in recent years • Not possible to split theoretical unmet demand calculation for debt vs. equity, but unmet demand for established SMEs as a whole amounts to c.£140m p.a. even if only 10% of rejected firms had solid business plans (in addition to the gap being addressed by current JEREMIE)	
Step 3 – Market Failure	• Strong demand for JEREMIE small loans (62% between £15k and £50k). Strong performance against economic outputs and reasonable financial returns given the typically higher default rates in this market segment • Overall performance of ERDF funded schemes led by Key Fund suggests market failure • Suggests viable firms in this segment	• Strong consensus amongst consultees of a structural long term equity gap at the early stage • Performance of JEREMIE early stage Funds has been strong: fund fully invested, low default rates and strong economic returns • Suggests a good proportion of firms being supported at present are viable	• Evidence on bank lending suggests amplification of pre-existing market failures in region • Very strong demand for debt from JEREMIE Fund (original allocation increased from £27m to £32m) and strong performance on financial and economic returns. • Suggests significant market failure generally in SME debt finance • Also evidence from other initiatives (e.g. YCF) of market failures in specific sectors.	• Evidence of continuation of long term equity gap for growth capital and market failure for amounts of equity up to £3m or more • JEREMIE Fund demand hit by business confidence – also long term issues of equity aversion, but reasonable performance following reduction in Fund size

Step 4 – Persistence of Market Failure	• Consultations suggest banks likely to continue to focus on asset-backed, larger propositions in coming years • Market failure likely to continue for foreseeable future	• Evidence suggests mainstream players will continue to focus on larger, de-risked propositions • Very little provision outside of JEREMIE and limited impact of other interventions • Equity gap is a long term structural issue so likely to persist.	• Banks under continued pressure from regulation and increasing cost of capital – consultees view suggests unlikely to return significantly to SME market • P2P has grown but future path and sustainability unclear. • Economic recovery points towards increase in demand for debt and therefore potential increase in unmet demand.	• No sign of mainstream players moving away from fewer, larger deals, leaving a gap at lower levels of equity/mezzanine. • Economic recovery suggests demand for expansion could pick up and therefore increase unmet demand and market failure • Caution required: equity aversion still an issue in region.
Step 5 – Specific Economic Development Priorities	• Support for new businesses through start-up programmes identified as a priority for LEPs throughout region • Interventions to develop enterprise culture (e.g. through education) are emphasised in LEP strategies • **Analysis to be further tested and reviewed as part of Block two work**	• All LEPs place emphasis on SME innovation and are putting in place a range of related interventions • **Analysis to be further tested and reviewed as part of Block two work**	• Supporting the growth of existing businesses highlighted as a priority by all LEPs • Range of associated business support actions are supported • **Analysis to be further tested and reviewed as part of Block two work**	
Step 6 – Delivery Capacity	A good track record in the region of delivering publicly backed Funds. JEREMIE and other interventions have helped to develop the infrastructure, linkages and networks in the region, including stimulating demand for a range of types of finance and stronger investment readiness. Provides strong platform for any future intervention. **Analysis to be further tested and reviewed as part of Block two work as the potential investment strategy and delivery options are developed.**			