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

South West

January 2015

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Version	**Date issued**	**Scope**
Version 2	2-02-15	Revised following comments of GDTs

Area Overview: South West

This section provides an overview of the SME finance market in London, 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 report, which outlines the assessment framework which is used**. This provides 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.

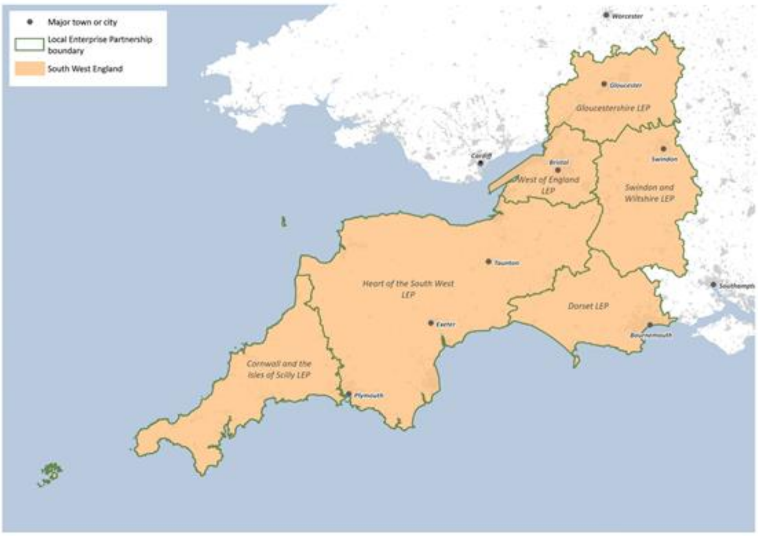
This section applies this assessment framework to the region and the overall conclusions and implications of this process are summarised at the end of the section. There are various limitations in the published data sets that are used to inform this assessment and various forms of uncertainty, all of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

1.1 Economic Geography

The South West is home to 5.4 million residents, 2.4 million jobs, 207,500 businesses, 98% of which are SMEs. The region's total Gross Value Added in 2012 was £101.6 billion, equivalent to £19,100 per head of population, which compares to an England average of £21,900.

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

Figure 0.1: The South West Region



- Heart of the South West: Torridge, West Devon, South Hams, Teignbridge, Exeter, East Devon, Mid Devon, North Devon, Plymouth, West Somerset, Taunton Deane, Sedgemoor, Mendip, South Somerset and Torbay;
- Cornwall and Isles of Scilly: Cornwall and Isles of Scilly
- Swindon and Wiltshire: Swindon and Wiltshire
- Gloucestershire: Cheltenham, Cotswold, Forest of Dean, Gloucester, Stroud and Tewkesbury
- West of England: Bath and North East Somerset, City of Bristol, North Somerset and South Gloucestershire; and,
- Dorset: Bournemouth, Poole, West Dorset, North Dorset, Weymouth and Portland, Christchurch, East Dorset and Purbeck.

The Heart of the South West LEP area contains 1.7 million residents (31% of the total population in the South West), and 65,600 enterprises, of which 64,500 are SME employers.[1] The overall business base represents 32% of the South West region's businesses. It contributes £25 billion in annual GVA, with the

[1] 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). We 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.

largest proportion of businesses located in South Somerset and East Devon. Agriculture, construction and professional and business services are the sectors representing the largest proportion of the business base.

There are 543,600 residents in the Cornwall and Isles of Scilly LEP area (10% of the total population in the South West), with 21,700 businesses, of which 21,300 are SMEs. Cornwall accounts for the greatest proportion of businesses, and is the centre point of the Newquay Aerohub Enterprise Zone for the area. The LEP area's economic structure is heavily weighted towards retail and tourism, particularly accommodation and food services.

The Swindon and Wiltshire LEP contains 693,700 residents (13% of the total population in the South West), and 65,585 enterprises, of which 25,900 are SME employers. The LEP contributes £14.1 billion in annual GVA, with over three-quarters of the business base located in Wiltshire. However, the GVA per head in Swindon is significantly higher than in Wiltshire, likely reflecting differences in the local area's sector base and the high presence of head offices in Swindon.

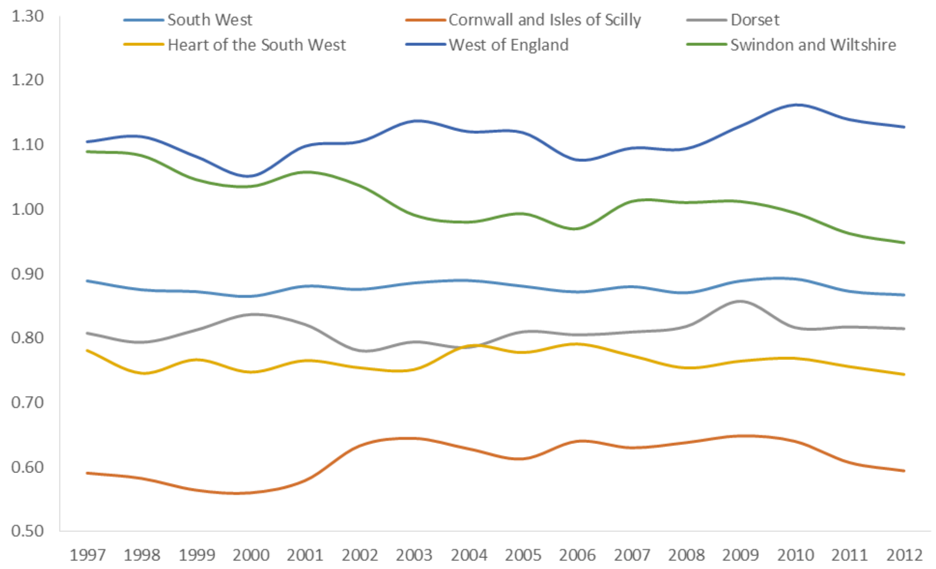
The Gloucestershire LEP contains 605,700 residents (11% of the total population in the South West), and 26,000 enterprises, of which 25,400 are SME employers. It contributes £13 billion in annual GVA, with the largest proportions of the LEP's business base located in Cotswold (22%) and Stroud (21%).

The West of England LEP contains 1.1 million residents (20% of the total population in the South West), and 38,900 enterprises, of which 38,100 are SME employers. Overall the LEP contributes £27 billion in annual GVA, with a large proportion (40%) of all businesses located in Bristol. In terms of sector activities, Bristol and Bath have a high concentration of TV, animation and publishing activities, comprising part of the Enterprise Zone in Bristol Temple Quarter.

Dorset contains 754,500 residents (14% of the total population in the South West), and 29,000 enterprises, of which 28,500 are SME employers. It contributes £13 billion in annual GVA, with the majority of the LEP's population and employment concentrated in East Dorset and Purbeck Districts. A large proportion of employment is in service sectors and ranges from activities relating to tourism to finance and banking.

Gross value added (GVA) per head of population for the six LEP areas has varied over the last few years. For the region it has increased from £11,600 in 1997 to £19,000 in 2012. However this increase is below that of England over the same period. The West of England and Swindon and Wiltshire are the only two LEP areas to outperform England's GVA per head over the majority of this period. However, since the recession Swindon and Wiltshire's performance has steadily declined to below the national level. Conversely, the performance of Cornwall and the Isles of Scilly's GVA per head has persisted significantly below the national level over the entire period: while England's GVA per head in 2012 was £22,000, that of Cornwall was £13,200, having increased from £7,700 in 1997.

Figure 0.2: GVA per Head (England=100) - 1997-2012



Source: Office for National Statistics

1.2 Policy

Policy towards business support in the South West is conditioned by the nature of the different economic challenges faced by individual LEPs. Broadly speaking, in the West and South West of the region these problems are all about issues of peripherality, remoteness from established sources of capital, and the dominance of lower value added, smaller service oriented businesses. Moving from the South West of the region to the East and North these problems are gradually supplanted by problems related to access to higher value skills, business space and supporting the growth of established, more highly capitalised sectors. This high level generalisation skates over some important development issues in the more affluent parts of the region, as well as the need to develop more knowledge intensive and innovative activity in more deprived areas.

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 growing businesses, support for start –ups and a focus on SME innovation. In addition there is stress on the need to support the growth of new sectors. As in other regions, this implies that there is a strategic context which would support the provision of finance in all the segments of the market that is being considered. There is a particularly strong emphasis in Cornwall and Isle of Scillies, Heart of the South West and West of England, with a focus on renewable, marine, agri-tech and related sectors.

Table 0.1: SME Competitiveness Priorities of SW LEPs

Priority Area	Actions identified
Cornwall and Isles of Scilly	LEP Priority Area One is inspiring businesses to achieve their national and global potential. The Operational Programme identifies 6 key strands of activity. These are: • New enterprise • High growth companies • Targeted business support • Infrastructure for a modern economy • Access to finance • 6. Environmental goods and services supply chain and market development
Swindon and Wiltshire	Five ESIF Activity Interventions: • SME Growth • Innovation for Sustainable Growth • Skills for Growth • Low carbon development; • Skills for Inclusion
Heart of the South West	Three major aims, creating the conditions for growth, maximising productivity and performance, and capitalising on our distinctive assets. Individual priorities include: • Simpler, tailored and more accessible business support system. • Stimulating enterprise and growth • Improving Access to Finance
Gloucester shire	The Strategic Economic Plan for Gloucestershire LEP has three key components, the second of which is attracting and retaining successful businesses in high value sectors. As part of this strategy the LEP is looking to use a Growth Hub approach to provide a range of services to support companies with high growth potential and encourage individuals.
West of England	One of five key objective to create business led, innovation driven, world-class support for local businesses with a focus on the LEP's target sectors, driving the creation of new products and services, investment and where necessary driving demand to enhance productivity.
Dorset	**Competitive Dorset**: Dorset businesses increasingly operate in a trading and investment environment, competitive with low cost economies overseas and increasingly competitive and sophisticated UK businesses. Moving firms up the value chain to enable them to be more productive and competitive is a key challenge. The objective of the Competitive Dorset theme is to "unleash the potential of existing businesses, encourage the creation of new ones and attract investment".

Source: European Structural and Investment Fund Strategies 2014-2020;

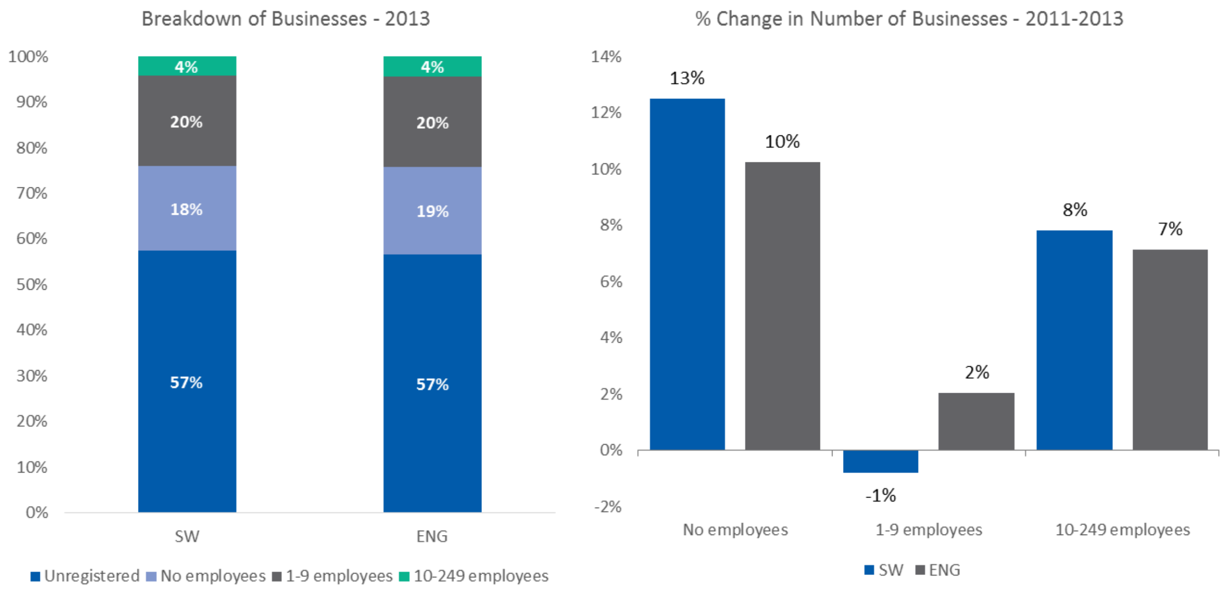
1.3 Business Demography Trends

1.3.1 Business stock

The region is home to 466,600 SMEs, of which 447,120 (96%) are microbusinesses (less than 10 employees), 17,100 are small (10-49 employees) and 1,200 are medium sized firms (50-249 employees). Of the microbusiness stock, 268,000 are unregistered for VAT/PAYE and 86,100 are sole traders.

The breakdown of businesses by size in the South West largely mirrors the profile of England, with over half of firms being unregistered businesses. Over the past few years the South West has seen the number of single person firms (both registered and unregistered) increase by 13%, which is greater than the UK average. However, the base of micro businesses has declined by 1% in the South West while across England it has increased by 2%. However, the rate of change for all other SMEs has been slightly greater than that of the UK, increasing by 8% in the South West compared to 7% nationally.

Figure 0.3: Composition (%) of SME Stock in 2013 and change 2011-2013



Source: BIS Business Population Estimates 2010-2013

Of the six LEP areas covering the South West, the Heart of the South West has the largest business base (65,600 firms) followed by West of England (38,900 firms).[2] The other LEPs have smaller business bases ranging from 21,700 in Cornwall and Isles of Scilly to 29,000 in Dorset. The composition of businesses by sized band in each area is the same; 88-89% are microbusinesses, 9-11% are small firms and 1-2% are medium sized businesses.

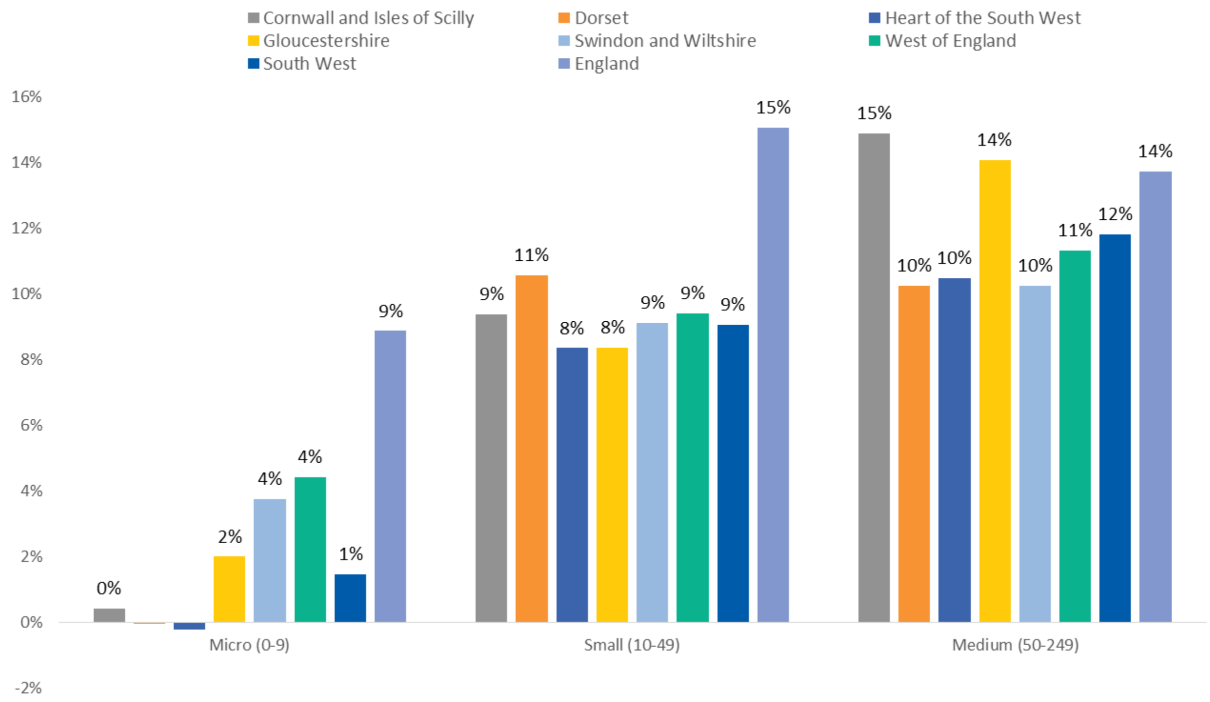
Business density is higher than the national average across all the LEP areas in the South West except for West of England LEP whose density is equal to that of England (46 business per 1,000 residents). The highest business densities are in Gloucestershire (43 per 1,000 residents) and Cornwall and Isles of Scilly (40 businesses per 1,000 residents). Business density varies across the region: areas such as Plymouth and Torbay (Heart of the South West), Gloucester and Weymouth and Portland (Dorset) have low

[2] Source: ONS Business counts data

business densities (around 25 firms per 1,000 residents) to areas with higher densities such as Cotswold, West Devon, South Hams and Mid Devon (66-56 firms per 1,000 residents).

Across the South West, growth in micro and small businesses has been lower than the national average over the period 2011-14 while growth in medium sized firms has been in line with England. However, some LEP areas have out-performed the national average. Amongst micro businesses West of England's business base growth exceeded that of England (10% vs. 9%) while Cornwall Isles of Scilly and Swindon and Wiltshire exceeded the national level of growth among the small business base. Gloucester, Cornwall and Scilly and Heart of the South West experienced an above average growth in their medium-sized business base.

Figure 0.4: % Change in Number of Businesses 2011-2013



Source: ONS Business Counts

Across the South West, the sectors with the largest SME business base are professional, scientific and technical (31,000 firms), construction (26,200 firms) and agriculture (23,500 firms). Across all sectors in the economy, micro businesses make up a greater proportion of the business base than small and medium sized firms. Given the size of the Heart of the South West LEP, its business base tends to represent about a third of all the region's businesses.

The SME bases in Cornwall and Isles of Scilly and Heart of the South West are the most heavily weighted towards agriculture – nearly 20% of each LEP area's SME business base is in agriculture, compared to less than 10% across the rest of the South West. Half of all agricultural firms in the region are located in heart of the South West LEP area. The high concentration of tourism related activity is also visible in Cornwall and Isles of Scilly – 20% of their SME base is concentrated in retail, accommodation and food services.

Half of the South West's professional, scientific and technical activities firms are concentrated in Heart of the South West and West of England (25% of sector business base, each).

1.3.2 Business Starts

In 2012 around 20,200 new businesses formed in the region, having increased by 13% since 2009 compared to a 15% increase across England. When the start-up rate is considered per 10,000 working age adults, the South West's performance (61) is also below the national average (70).

Within the South West, the highest start-up rates are found in Gloucestershire, particularly Cheltenham (113) and Cotswold (140). Swindon and Wiltshire also has a start-up rate (63) higher than the regional average with an even higher start-up rate locally and Wiltshire (66).

Table 0.2: Business Starts in South West and its LEP Areas, 2009-12

	Business Starts				Business Starts per 10,000 WAP (2012)	
	2009	2012	Abs Change		Number	England=100
Cornwall and Isles of Scilly	1,500	1,700	75	5%	53	76
Dorset	2,700	3,000	300	11%	66	95
Gloucestershire	2,300	2,600	400	16%	69	99
Heart of the South West	4,800	5,500	300	6%	54	77
Swindon and Wiltshire	2,500	2,700	400	18%	63	90
West of England	4,000	4,700	800	22%	56	80
Total South West	18,000	20,200	2,300	13%	61	87

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's business database. 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. These are the kinds of firm that are likely to have a need for external finance to support this expansion.

The latest report found that 20.8% of businesses with a turnover of between £2.5 million and £100m in the region fall into this high growth category. Although this ranked the South West 8th out of 9 English regions, the proportion has increased since 2011 (16.7%) and in 2012 achieved a proportion greater than the England average (22.2% vs. 20.9%).

Table 0.3: High Growth Firms as a % of all Businesses, 2011-13

	2011 Population of High Growth Firms	Regional Rank (2013)	2011	2012	2013
South West	244	8th	16.7%	22.2%	20.8%
England	4,044		16.9%	20.9%	22.0%

Source: BGF Growth Companies Barometer

1.3.4 Innovation activity

The South West overall performs relatively well on a range of indicators of innovation. Approximately 47% of the business base in the region is innovation active. This is higher than the UK average rate of 45%, and is the second highest of all the regions.[3]

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 in the South West has increased significantly from 2001 to 2012, from £1,400 million to £2,000 million which represent an increase of 44%. Across the three categories of R&D expenditure (GERD, HERD and BERD), HERD has increased the most in proportional terms over this period (98% increase). However, the latest figures show that overall R&D spend in the South West (£2,100 million in 2012) is below the regional average across England (£2,700).

There have been 81 spinouts in the South West since the year 2000, representing 9% of all spinouts in the UK. This is the second lowest of all regions and when analysed in proportion to the size of the region's working age population, it has the lowest number of start-ups per head (20). Half of all spin-outs in the South West have come from the University of Bristol, (40 spin-outs) with an additional 25% (20 spin-outs) coming from the University of Exeter.

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 working age 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[4] suggest that the South West had an above average TEA measure and the third highest across the nine regions. However, it has below average performance in measure of high growth aspirations (both TEA and number of firms).

[3] Source: BIS (2010), UK Innovation Survey

Table 0.4: Measures of Entrepreneurial Activity, 2008-13

Highlighted cells shows above average results	TEA	% of Opportunity E'preneurs	Stages of Entrepreneurial Activity				High Growth Entrepreneurial Aspiration[5]	
			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%
West Midlands	5.9%	4.2%	6.0%	2.7%	3.1%	5.6%	16.5%	5.1%
North West	5.9%	4.3%	4.0%	3.0%	2.8%	5.7%	14.4%	5.0%
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.

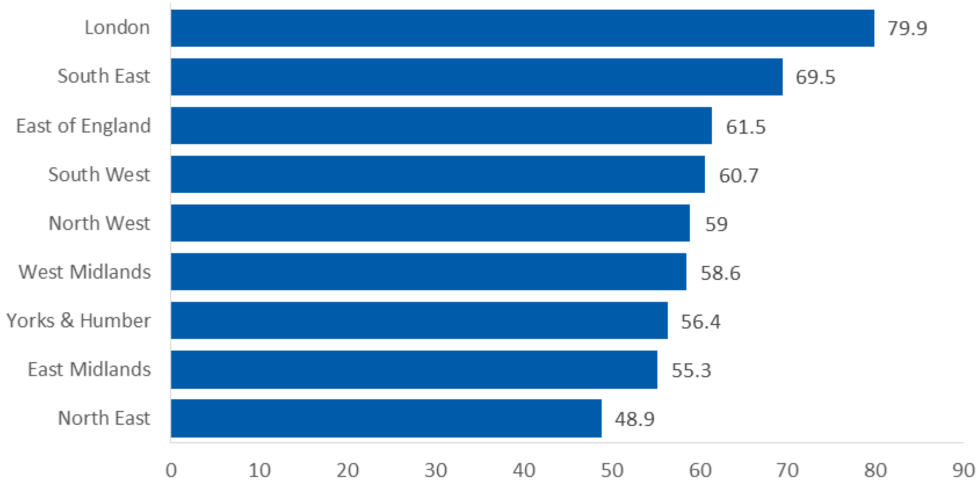
The Santander Enterprise Index is an annual ranking of "the UK's regional entrepreneurial ecosystems." It uses a methodology developed by the Global Entrepreneurship and Development Institute (GEDI) to create an index for each of the UK regions, examining performance against 15 pillars of entrepreneurship. 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 shows that the South West performs relatively well compared to the other regions throughout England (4th highest overall). At the local level, Bristol has a particularly high enterprise score, ranking 9th in a list of the top 10 towns and cities across the UK.

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

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

Figure 0.2: 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.

44% of SMEs surveyed in the South West in 2013 had used finance of some sort[6] over the past five years. 53% had not used finance at all over this period. 38% had used either an overdraft, loan or credit card. 37% 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 in the South West is below the average proportion in England (40%).

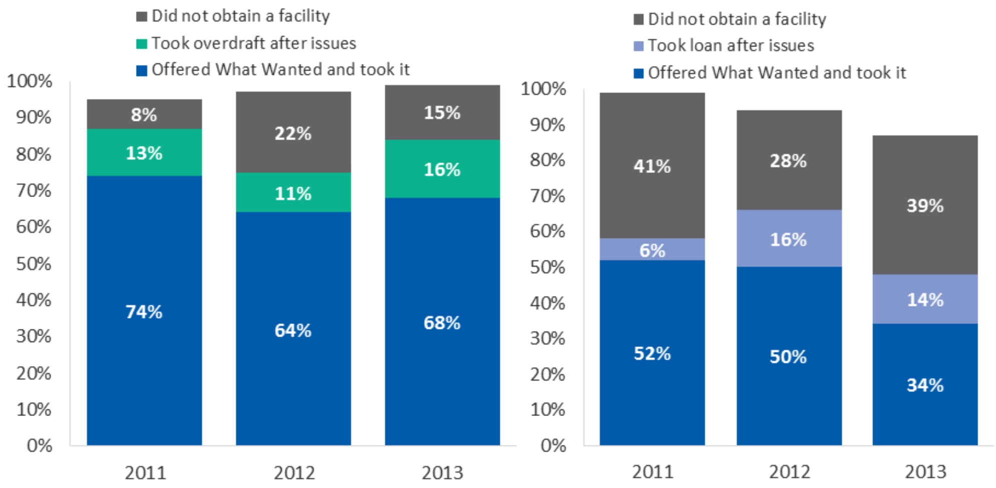
10% of SMEs in the South West applied for a new overdraft or loan facility or sought to renew an existing facility. This figure has decreased from 16% of SMEs in 2011. The number of SMEs successful in their application for overdrafts and accepted what was offered has also decreased from 74% in 2011 to 68% in 2013. However a greater proportion of SMEs have reported issues[7] in their application before approval.

[6] 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.

[7] Issues is defined by BDRC as “something that needed further discussion before a loan or overdraft facility was agreed, typically the terms and conditions (security, fee or interest rate) or the amount initially offered by the bank”

Figure 0.3: Overdraft and Loan Applications in the South West - 2011-2013

Overdrafts *Loans*



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"

There are two barriers to applying for a loan or overdraft which have been increasingly cited by SMEs in the South West between 2011 and 2013. In 2011, 25% of SMEs who would have liked to apply for a loan or overdraft over the past 12 months didn't because they were discouraged either directly by the bank or indirectly because they thought they would be turned down. This proportion rose to 48% in 2013. Additionally, the proportion of businesses who didn't apply because they had issues with the principle of borrowing increased in the South West from 21% in 2011 to 40% in 2013. Issues with the principle of borrowing refers to those firms who thought they would either lose control of their business or preferred alternative sources of funding.

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 the separate review of the extent to which SMEs seeking this type of finance were successful in obtaining it.

It should be noted that partners in the South West have commissioned a study of the SME finance gap specifically in Cornwall and the Isles of Scilly LEP area from PWC. Key findings from this analysis are:

- An estimated 200 to 600 growth businesses per year are unable to obtain finance from traditional sources, the majority of which are micro-enterprises who are unable to gain funding at that level;
- Emerging and innovative sectors lack development capital and early stage support (these include marine technology, e-health, digital, aerospace, creative and renewables).

- There is a lack of locally available equity financing. The report did not provide an estimate of the equity gap, but called for a fund of £8-13m, catering for 40-65 investments of approximately £200k.

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 South West's business base to provide indications of the number of SMEs different sizes that may be struggling to obtain the finance they are looking for, and hence the value of unmet demand.

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

- In 2012 there were around 26,700 SMEs in the region looking for external finance, of which 20,500 were microbusinesses
- Of these, around 12,600 had difficulties of some sort in obtaining this finance
- 8,600 SMEs obtained none of the finance they were looking for, and 1,600 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).
- 5,900 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 0.5: Illustrative Analysis of SMEs' Experience in Accessing Finance in the South West, using Survey Data 2012/13

	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)	93,000	20,500	10,200	7,200	1,200	5,200
Small (10-49)	17,100	5,500	2,100	1,400	300	600
Medium (50-249)	2,400	800	200	100	50	50
All SMEs	**112,500**	**26,700**	**12,600**	**8,600**	**1,600**	**5,900**

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 over and above that being provided at the time by the private and public sectors. . This analysis shows that total unmet demand in the region could be of the order of £1.7 billion in one year. It is not possible to determine from this type of analysis how much of this 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 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 these were viable, this would imply a finance gap of £5 million for microfinance, £90m sought by micros seeking small loans, and a further c£80 million sought by small and medium sized SMEs. **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 also 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 £140 million per annum for debt (if 10% of propositions were viable) and around £14 million per annum for equity (again if 10% of propositions are viable), in addition to that which is already being met by publicly backed initiatives.

Table 0.6: Illustrative Analysis of Unmet Demand (£millions) for Finance from SMEs in the South West, 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	£50	£860	£470	£230	£1,610
- those that obtained some, but not all, of the finance they were looking for*	£0	£40	£20	£20	£90
Total unmet demand	**£50**	£900	**£500**	**£260**	**£1,700**
Scenarios for % that are viable					
10%	£5	£90	£50	£30	£170
20%	£10	£180	£100	£50	£340
30%	£15	£270	£150	£80	£510
40%	£19	£360	£200	£100	£680

**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 the 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 £160 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. 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 be different from those in 2012.
- Regeneris Consulting do not know from the survey whether businesses in the South West were more or less likely to be successful in obtaining finance than those in the UK as a whole consequently the difference between regions are explained by the differences in the size and the structure of the business base rather than the demand for finance.
- Although the survey tells us 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 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 more 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:

South West Loans Fund provides two other ERDF backed products – Small Loans for Business (SL4B), and Finance for Business Loans (F4B). SL4B is aimed very much at the microfinance market, with an average loan of £25k to £30k. Demand for this product is solid, but slightly behind profile with 151 SMEs assisted against a target of approximately 250. The SL4B originally provided £4m, which has subsequently been increased to £6.8m.

F4B is for larger portions of debt, with average loan size of £147k, with strong demand and 77 SMEs assisted with £10.8m funds dispersed. Here demand is outstripping the fund's original investment profile. F4B had an original size of £7m, although £11.9m has now been leant following re-lending of the original capital amount. The fund is now fully invested.

SWIG also operates the South West Microloans Fund, originally in Bristol, Plymouth, and Torbay. Originally designed as a £2m fund, it has been reduced in size to £1.5, and expanded in scope to include retail. This reduction is scope was the result of lower than expected take-up. The geographical reach of the fund was also expanded in March 2013 to cover all deprived urban areas within the South West, with the exception of Cornwall and the Isles of Scilly. Performance and demand for the fund has been steady if not spectacular, with a total of 270 SMEs assisted, against 894 enquiries with an average investment of just over £5k.

The only quasi equity/co-investment scheme which has been recently operational in the Heart of the South West area has been the SW Cleantech Fund Co-investment Scheme providing medium term loans with bullet repayments alongside business angel investors. This is a relatively small and specific fund (£2.5m) over a short period only targeted at the Clean Tech sector. It is also operated over the whole of the South West with only 16 investments in total.

There are a number of business grant schemes in operation across the regions, which include Business Investment for Growth, Superfast Cornwall Fund, and the Business Catalyst Fund. Together these funds have assisted 322 SMEs, providing grants of £3.6m.

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

Table 0.7: Summary of Key SME Finance Demand Indicators in the South West

Microbusinesses and start-ups	• 447,000 microbusinesses in region (including 86,000 zero employees and 268,000 unregistered businesses) • Some growth in micro stock -> necessity entrepreneurs • Start-up rate 12% below UK avg, but business starts growing • Relatively strong performance in region on enterprise indices (GEM, Santander Enterprise Index) • Total theoretical unmet demand of £50 million per annum in addition to that which is served by existing interventions, £5m of which would be accounted for by microfinance
Early stage businesses	• Region has a high proportion of lower value service sector employment • … but performs quite well on spin-outs (rank 3rd of English regions) • Universities of Bristol and Exeter account for majority of spin-outs • Evidence points to solid demand for existing loan schemes

Established SMEs[8]	• 18,300 established SMEs (10-249 employees) • 22% of SW firms with t/o £2.5m-£100m defined as *high growth* *(Eng = 22%)* • Theoretical unmet demand of £80 million per annum assuming 10% of total unmet demand is viable, including small and larger loans and equity, which is in addition to that already being addressed by existing interventions.

Source: Various

1.5 Supply of External Finance

The key trends in the supply of finance by market segment, are summarised below, using publicly available data. In the discussion of supply reference is made to the performance of the current available Funds and other publicly backed instruments where this is available. This draws on the latest available performance data, and insights from the consultations with financial intermediaries and similar bodies. A summary table of the relevant sources of supply is provided at the end of this section.

1.5.1 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 South West fell between Q3 2011 and Q2 2014 from £706m to £545m (-23%), by a slightly larger proportion than in the UK as a whole (-20%). This fall was felt by both medium and small businesses. Consultations suggest that the region was particularly disadvantaged because of the importance of lower value service sector jobs in the region.

The total stock of loans held by SMEs in the region actually increased by 30% to £2,741 million, compared to a 2% fall across the UK. The data suggests that the value of new loans issued by banks decreased by 21% for small businesses and increased by 24% for medium sized businesses.

This headline data obscures the nuances of SMEs' experiences in the region. Evidence from consultations with banks and the professional advisory community confirm that businesses in the region suffered from the general tightening up of bank finance around the financial crisis, especially in particular sectors to which banks wished to reduce their exposure and for those whose businesses had a strong seasonal element. This includes the hospitality and wider service sector. There is some survey evidence to support this from the SME Finance Monitor presented earlier. The data also obscures the reality that SMEs at the smaller end of the SME market, particularly microbusinesses, have been particularly affected by this readjustment

[8] Regeneris Consulting would caveat that defining an established SME as one with 1 0 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.

The SW Microcredit Fund has been operational since June 2010 and provides small loans under £7,500 (for the first two years £5,000) to start up and early stage businesses. The Fund has assisted 188 SMEs, creating or safeguarding 185 new jobs.

The South West Loans Fund provides two products – Small Loans for Business (SL4B), and Finance for Business Loans (F4B). SL4B is aimed very much at the microfinance market, with an average loan of £25k to £30k. F4B is for larger portions of debt, with an average loan size of £147k, with strong demand and 77 SMEs assisted with £10.8m funds dispersed. Here demand has outstripping the fund's original investment profile.

In addition to these publicly backed financial instruments, a number of grant schemes operate on sub-regional or regional basis. By means of an example, Table 9.8 shows data for those instruments available in Cornwall and the Isles of Scilly.

Table 0.8: Summary of ERDF and Other Public Sector Backed SME Grant Schemes

[Investment period to be checked]	Business Investment for Growth	Superfast Cornwall Fund	Business Catalyst Fund	Total
Funding Stream,	ERDF	RGF	RGF	
Total Grant Available	3,362,000	870,721	4,801,209	9,292,930
Total Applications Approved	3,486,644	870,721	4,801,209	8,628,395
No's of Business – approved applications	200	83	39	322
Average Grant Size	£17,433	£9,430	£111,771	£29,796
Total Grant Paid	1,756,153	274,475	1,591,779	3,622,407

Source: South West Investment Group; data provided Q4 2014.

The UK Government has been active in trying to stimulate the flow of lending to SMEs in recent years. The main initiatives have included:

- 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, and that lending has been focussed on mortgages.[9]
- Enterprise Finance Guarantee (E.g.). The value of EfG-backed loans is the fourth highest of the English regions, behind London the SE, and the NW. 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.10 To date, £66m

[9] 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.

has been invested in the region, which is equivalent to an annual average of 38 million. The average value of investment was £200k, equal to the English average. The overall funding secured across the SW equates to £339 per SME, which is below the England average of £500.
- The Start-up Loans initiative, set up in 2012 to help 18-30 year olds, has had some impact in the South West. The latest statistics show that £3m in total has been allocated to 550 start-ups in the South West.

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 and set out in the main report. 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 not regional data on P2P business lending, but it has reportedly had some take up in the South West. Consultations have reported that this is especially true in Bristol and to the North of the M4 where proximity to the more sophisticated investment infrastructure of London and Birmingham is important.

Another point raised in consultations in the North of the region is that in advanced manufacturing and engineering sector, foreign investment by supply chain leaders is an increasingly important source of development capital. Often, overseas companies will invest in strategic suppliers to ensure quality and speed of response.

There is 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: In the South West in 2013, £7.8m was invested by CDFIs in 162 businesses representing 15% of the national investment and 8% of the businesses.
- Local authority run schemes.
- RGF backed schemes (see above).

1.5.2 Early stage finance

As was 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 the South West fluctuated significantly between 2007 and 2010: while £28 million was invested in 2007, this dropped to £12-14 million in 2008 and 2009. After rising to £38 million invested in 2010, this figure has continued to fluctuate, dropping down to an average of £8 million in 2011 and 2013. Since 2010 the number of firms receiving investment in the South West has declined. Before 2010, an average of 27 companies were invested in each year, dropping to an average of 12 per annum over the period 2011-2013.

A number of national initiatives have had some impact on the early stage funding landscape in the South West. These include:

- 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 a total of £3.8 million (including investment by co-investors to the ACF) has been

[10] 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.

invested in the South West, in 3 companies. This represents 4% and 6% of the value of investment and number of companies in the UK, respectively. We do not have access to regional data on leverage but at the national level to date £3.80 has been levered in from business angel syndicates for every £1 invested by the ACF itself. At this stage it is clearly too early to judge the level of returns – the data available to Regeneris Consulting is at the national level, which states that one exit has been achieved at a 3 times return.

- 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. For various reasons, two thirds of the value of investment made to date has gone to companies based in London, South East and East of England. The latest monitoring data shows that 11 investments have been made in the South West to date, with a value of £20.4 million (including co-investment).
- UK Innovation Investment Fund. This Fund 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. 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 at total of £119m has been invested through the EIS scheme, in 479 enterprises over 2009-2012, an annual average of around £36m. This is equivalent to £323 per SME employer, which compare to the English average of £650.There appears to be a general consensus from our consultations that these initiatives have had a strong impact in bringing forward investment from business angels and High Net Worth Individuals in the early stage arena.

Again, 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). Consultations suggest that these routes have had little penetration in the South West 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 also had little penetration 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.

1.5.3 Later stage growth finance

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 has steadily increased from 1998 when annual investment was £267 million to 2010 when it had risen to £739 million. While the overall trend has been positive, there were years of decline, particularly 200, 2002 and 2004 when average annual investment was £152 million. After reaching a peak in 2010, annual investment figures in the South West have been much lower over 2011-13, averaging £236 million per annum. The number of companies invested in each year has steadily declined since 2006 (98 companies) to 2010 (46 companies) and remaining steady thereafter. Given the role that business confidence plays in driving demand for this type of investment, these Funds faced a more challenging climate than the other Funds. Unlike businesses in their early stages of product and business development, established SMEs can easily postpone growth projects whist they wait for conditions to improve. Our consultations suggest that this happened in the South West (as it did in other regions), particularly around 2010 and 2011.

There are also 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 focuses on growth equity and mezzanine finance, offering £2m-£10m. It is designed to be an evergreen fund. Published data on the Fund's portfolio indicates that only one £6 million investment has been made in the South West to date (compared to an average investment of £5.6m in England). This chimes with the comments from stakeholders that the Fund is investing in larger propositions in the £2m-£8m range.
- **Enterprise Capital Funds** , the British Business Bank scheme, can also invest in later stage businesses (see above).

An overall summary of the key sources of supply of finance to SMEs is provided below. It should be noted that there are significant overlaps between the sources (for example, EfG backed lending is a subset of total SME lending; some funding sources will have provided co-investment for other). Nonetheless, it gives a useful summary picture of the supply side in the region.

Table 9.9: Summary of Key Sources of SME Finance Supply in the South West

	Average annual value of Investment, £m	Average value of investment made, £000s (England avg in brackets)	Value per SME Base (England average in brackets)	% change in value 2011-13 (England avg in brackets)
Debt				
New loans to Small Businesses	£902	£76 (£82)	£8,019 (£7,342)	-21% (-12%)
New loans to Medium sized businesses	£1,839	£244 (£295)	£16,351 (£11,303)	24% (1.5%)
New overdrafts approved for Small Businesses	£393	£16,899 (£15,590)	£3,493 (£2,094)	-33% (-25%)
New overdrafts approved for Medium sized businesses	£313	£67 (£81)	£2,787 (£2,229)	9% (-5%)
Enterprise Finance Guarantee backed lending	£37	£90 (£100)	£330 (336)	NA
Start-up Loans	£3	£5 (£9)	£25 (£65)	£0
Business Finance Partnership & Investment Programme	£38	£200 (£207)	£339 (£500)	NA
ERDF backed debt	£3.74[1]	£68 (£83)	£57 (£40)	£1
P2P Lending to businesses	NA	NA	NA	NA
Equity				
Early stage equity investment	£9	£452 (£1,081)	£83 (£355)	-67% (24%)
Expansion equity investment	£71	£2,511 (£4,830)	£631 (£1153)	-50% (62%)

Angel Co-Fund	£1	£1,277 (£1,832)	£12 (£30)	NA
Enterprise Capital Funds	£3	£1,852 (£1,335)	£23 (£27)	NA
Enterprise Investment Scheme (EIS)	£36	£228 (£344)	£323 (£650)	(66%)
Business Growth Fund	£6	£3,210 (£5,617)	£21	zero in 2011/12
Equity-based crowdfunding	£5	NA	£42 (£26)	(46%)
Other crowdfunding (reward-based, donation)	£7	NA	£60 (£35)	NA

Source: BBA, BVCA, NESTA, HMRC, BGF. Note: a detailed explanation of the sources and coverage of the data is provided in Appendix. Notes: [1] Based on five year average [see table 9.10]

1.5.3.1 *Performance of ERDF backed funds*

The South West has an established track record in the delivery of public sector backed SME finance initiatives, dating back to relatively small-scale interventions in the 1990s to larger Funds in recent ERDF programmes. The table below summarises the key Funds and illustrates the range of finance types provided over the period and market areas focussed upon.

Table 9.10: Summary of ERDF Backed FIs in the South West

<table>
<tr><th>Fund</th><th>Type of Finance</th><th colspan="2">Value</th><th>Investment Period</th></tr>
<tr><td>South West Microcredit Fund</td><td>Debt</td><td colspan="2">£1,500,000</td><td>Ends 3112 2015</td></tr>
<tr><td>South West Loan Fund: Small Loans for Business (Competitiveness and Convergence streams)</td><td>Debt</td><td>£4m initially</td><td>£6.8m to be invested by 12/15</td><td rowspan="2">Ends 2015</td></tr>
<tr><td>South West Loans Fund: Finance for Business Loans (Competitiveness and Convergence streams)</td><td>Debt</td><td>£7m initially</td><td>£11.9m fund now fully invested</td></tr>
<tr><td>SW Cleantech Fund</td><td>Equity</td><td colspan="2">£2,500,000</td><td>Ended 30/6/2013</td></tr>
</table>

Source: Various

The experience of managing these various funds has provided very valuable learning for the region over time, and has helped to develop the SME finance ecosystem, bringing new fund managers to the region and developing relationships with the professional advisory community as well as mainstream finance providers. They have also provided legacy funding for future projects. Experience of providing publicly backed financial instruments is concentrated in the West and South of region, matching the current activities of SWIG.

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 FIs during the 2014-20 programming period in the region. This is done with reference to the market assessment framework presented in the main report. **The final two steps of the market assessment 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.

	Micro Finance	Early Stage VC	Debt for Growing, Established SMEs	Expansion Equity for Established SMEs
Step 1 - Demand and Supply Characteristics	• 447,120 microbusinesses in SW (including 86,000 sole traders and 268,000 unregistered businesses • Region performs relatively well on enterprise indices (GEM, Santander Enterprise Index) – helped by strong performance of Bristol. • 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	• Approximately 47% of the business base in the region is innovation active. This is higher than the UK average rate of 45%, and is the second highest of all the regions. • There have been 81 spinouts in the South West since the year 2000, representing 9% of all spinouts in the UK. Half of all spin-outs in the South West have come from the University of Bristol, (40 spin-outs) with an additional 25% (20 spin-outs) coming from the University of Exeter. • V. low penetration of crowd-funding in region to date • Tax incentives have had an impact.	• 18,000 established SMEs in the region • 21% of SW firms high growth (England= 22%; SW rank 8th out of 9 regions); but increasing • Business confidence severely hit 2010-12 and asset value impacted -> reduced demand for equity • Some cultural issues with equity finance in region (equity aversion) • But steady demand for Growth Funds • Few other mainstream sources • Small Loans for Business (SL4B) currently undersubscribed, but making up lost ground. • Importance of Foreign Direct Investment in Wilts, Swindon and Bristol	• 18,000 established SMEs in the region • 21% of SW firms high growth (England= 22%; SW rank 8th out of 9 regions); but increasing
Step 2 – Unmet Demand	• Strong evidence pointing towards particular, and growing, difficulties experienced by micro-businesses in obtaining finance • Theoretical unmet demand of c.£95m p.a. if only 10% of rejected firms had solid business plans (in addition to the gap being addressed by current CDFIs and Funds)	• Continued austerity -> necessity entrepreneurs • Improved economic climate -> more start-ups? • Other sources (e.g. start-up loans, spatially targeted microloan programmes, Superfast Cornwall, Business Catalyst) filling some, but not all, of the gap	• 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.£80m p.a. even if only 10% of rejected firms had solid business plans (in addition to the gap being addressed by current provision)	
Step 3 – Market Failure	• South West Microloan Fund: £1.5m fund, with (as at 31/3/14) £963,000. Invested. Good performance against economic outputs, reasonable financial returns, although default rate slightly higher than originally forecast. Fund size recently reduced. • Overall performance of ERDF funded	• Strong consensus amongst consultees of a structural long term equity gap at the early stage • 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 SWLF choke Fund and strong performance on financial and economic returns. • Suggests significant market failure	

	schemes suggests market failure • Suggests viable firms in this segment		generally in SME debt finance • Also evidence from other initiatives of market failures in specific sectors.	
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 • Equity gap is a long term structural issue so likely to persist.	• Banks under continued pressure from regulation and increasing cost of capital – consultee views 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 solid track record in the region of delivering publicly backed Funds. A range of 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 and the development of the potential investment strategy and delivery options.**			