



heart of the
south west

local enterprise partnership

ACCESS TO FINANCE

DISCUSSION DOCUMENT

18th MAY 2021

CONTENTS

1. HIGH LEVEL FINDINGS
2. SUMMARY OF KEY ISSUES FOR AF2
3. HotSW POSSIBLE SOLUTIONS
4. EXECUTIVE SUMMARY

HIGH LEVEL FINDINGS

- **Access to Finance (A2F) remains a key concern for Small and Medium Enterprises (SMEs)**
- **UK SME confidence in securing finance in next 3 months - Q4 2020 (BVA)**
 - 40% confidence in Micro businesses v 61% Q4 19
 - 59% confidence in 10-249 employees v 75% Q4 19
 - Importers & exporters confidence levels positive and similar to 2015
- **Current A2F ecosystem is changing rapidly due to**
 - Phasing out of furlough and government grant / support schemes
 - Repayments to Government backed loans schemes due to begin soon
 - Deferred payments to HMRC need to be repaid
 - Transition of Government backed loan schemes to the Recovery Loan Scheme (RLS)
 - Tax regime from March 2021 Budget, super tax & VAT
 - Behaviour of pandemic in UK and worldwide
 - Post Brexit transition disruption
 - Tough insurance market, impacting on credit limits for SMEs

HIGH LEVEL FINDINGS

- **General economic conditions**

- Unemployment below expectations but likely to increase as furlough ends
- SMEs debt levels have doubled in last 12 months
- Historically low interest rates
- Inflation currently low, but inflationary pressure may emerge

- **Factors influencing lenders**

- High proportion of SME lending is with “Big 5” High Street Banks
- Big 5 continue to centralise decision making for lending
- Centralised lending decisioning reduces diversity of credit appetite
- Low interest rates squeezes bank profit - Net Interest Margin reduced
- Increased regulation and scrutiny encourages lenders to hold more capital
- Anti Money Laundering and Know Your Customer requirements absorbing resource
- Emergence of significant new sources of debt
 - Upper end of SME segment
 - Specialist and growth funds

HIGH LEVEL FINDINGS

○ HMRC Crown Preference Changes 1st December 2020

- Applies to debts in insolvency procedures commencing after 1 December 2020.
- Asset realisations are paid out to the following classes of creditor in this order:
 1. secured creditors with a fixed charge (after costs of realisation)
 2. insolvency practitioners' fees and expenses
 3. preferential creditors
 4. secondary preferential creditors
 5. prescribed part creditors
 6. secured creditors with a floating charge
 7. non-preferential creditors
 8. shareholders (for insolvent companies) or individual (for personal insolvency cases)
- Only certain specified HMRC debts are included. These are:
 - Value Added Tax (VAT)
 - Pay As You Earn (PAYE) Income Tax
 - employee National Insurance contributions (NICs)
 - students loan repayments
 - Construction Industry Scheme deductions
- Impact of changes yet to filter through, we anticipate a likely reduction in lender appetite to agree finance without security in the form of fixed charges.

HIGH LEVEL FINDINGS

○ What are our SMEs feeling?

- FSB findings (26/4/21) 69% SMEs now borrowing; up from 56%
 - Take up of RLS is 25% of level seen for CBILS & BBLS
 - Reasons given are tightening bank under writing and costs
 - 40% SMEs describe their indebtedness as unimaginable compared to 13% in 2019
- ONS March 2021 report expected losses from BBLS between 30% & 60%
 - April feedback expected losses 30% - 40%
- Press report 29/4/21 state SMEs are optimism has increased
 - 70% expect to survive
 - 73% report better trading compared to coming out of previous lockdown
 - 54% confident about the next 12 months
 - Micro businesses much less confident at 32%, small 65% and Medium 66%
- FSB South West feedback in March 21 survey
 - 49% expected to grow moderately or rapidly over next 12 months
 - 10% expected significant contraction

HIGH LEVEL FINDINGS

- **56% of South West employees aspire to run their own business (UK 64%)**
 - Less than a third expect it to happen
 - However 2020 saw an 8.3% increase in new business starts (Virgin survey Dec 2020)
- **Heart of the South West Region broadly reflects the UK in terms of sentiment and structure**
 - However increased reliance on tourism
 - Increased prevalence of Micro Businesses
 - Social enterprises appear 'lost in the data'
 - Less entrepreneurship historically – doesn't appear to have changed given above
 - Survival rates for SME's historically better
 - Number South West business per head population above national average
- Note: Standard data and surveys includes Bristol in definition of South West Region, which can cause a distortion when considering the region South of Bristol

- **Availability of credit dependent on segments**

- Larger end of SME for all purposes – excellent, with a wide range of funding options available
- Smaller end of SME – good, can be challenging for businesses without asset backing
- Start Up – moderate, often reliant on personal credit worthiness (even taking out personal loans) and under pinned by Start Up Loan programme (SULP)
- Micro and Scale-up – challenging, often lack asset backing, >2 years old don't qualify for SULP therefore Recovery Loan Scheme likely to be only option

- **Availability of credit dependent on sector**

- Tourism and Leisure – varying LTV; quality matters, cashflow after cap ex key
- Construction – dependent upon size and purpose (vehicles – good but debtors poor)
- Manufacturing – generally very good; stock funding poor
- Retail – varying LTV and sub sector – food good
- Services – appetite will vary with size and purpose
- Agriculture – good especially at <50% LTV
- Social enterprises reported lack of understanding by majority of lenders

HIGH LEVEL FINDINGS

- **Availability of credit dependent on purpose for funding**
 - Asset finance – wheeled assets – excellent
 - Asset finance – Plant & machinery assets – good
 - Commercial mortgages – good for <50% LTV – SME segment matters above 50%+ LTV
 - Commercial real estate – good choice of lenders
 - Invoice finance – excellent
 - Stock finance – SME segment matters, some specialist lenders and RLS
 - Overdraft – poor where no tangible security – HMRC Crown – see slide 6
 - Cashflow/Leveraged lending – good for medium businesses; tough for small businesses and start-ups
 - International Trade Finance - SME segment matters, Government support schemes & RLS
 - Supply Chain Finance – very poor for SME – opportunity for larger businesses with strong CSR, to support regional supply chains
 - Specialist lenders & growth funds – strong increased supply for bigger bus. – SaaS funding
 - Crowdfunding – Good especially for social enterprises
 - Peer to peer – Good appetite remains
 - “Growth / Working capital” – defined by lenders as losses! Redefine using categories above.

HIGH LEVEL FINDINGS

- **Use of Business Advice and Support in HotSW**
 - 70% SME's would consult accountant to help access to finance
 - Of the 70% who said they'd use an accountant to assist with raising finance only half of the above (35%) actually did – over a 3 year period
 - Similar drop off with banking partners??
 - Feedback from accountants as to why SME's don't consult them more often
 - concerns of SMEs around cost – “time clock ticking”
 - lack confidence of success
 - embarrassment of getting declined
 - lack of knowledge about the types of finance available
 - leave applications to the ‘last minute’
 - When advice sought feedback from clients positive
 - Similar positive story with SW Growth Hub
 - Micro businesses more likely to consult with friends, family and peers
- ICAEW and BBB - The Business Finance Guide is an excellent reference tool for advisers and SMEs with a good level of financial knowledge and understanding

SUMMARY OF KEY ISSUES FOR AF2

- i. SME funding gap is an historical issue exacerbated by Covid 19 pandemic
- ii. Issue greater for Micro and Small business - account for 90% of South West businesses
- iii. Medium businesses, on the whole, enjoying good credit conditions
- iv. Big 5 lenders account for 85%+ of SME lending and lack diversity of approach
- v. Significant concerns from small and micro business - reduction in face to face support from lenders
- vi. Social enterprises feel they're not understood by lenders not helped by previous point v.
- vii. CBILS highlighted the positive role that alternative finance providers can make
- viii. Asset backed lending reduced significantly in 2020 in favour of CBILS but expected to bounce back strongly in 2021 fuelled by the Super Deduction tax
- ix. Even then overall approval rates for CBILS was c35%
- x. SMEs that take advice about accessing finance from professionals and/or Growth Hub report a good experience
- xi. Drop off in take up of advice from those intending to take advice suggest lack of awareness of benefit
- xii. Significant uncertainty in economy remains due to political, health at home and abroad
- xiii. Ending of government support schemes, impending start of repaying deferred payments, loan repayments; toughening insurance market and Big 5 underwriting
- xiv. Potential liquidity is excellent with PE, growth and specialist debt funds all looking for investment opportunities

EXECUTIVE SUMMARY

The Heart of the South West Local Enterprise Partnership (HotSW) commissioned Isca Ventures LLP to deliver a piece of research to inform the development of services that will support SMEs to grow and thrive. This report looks to define and evaluate the barriers to finance, both in the form of businesses' access to finance, and investors' readiness to provide that finance.

The research was based on data evidence for Access to Finance from an independent survey carried out in January 2021 across the HotSW LEP. The results of this survey were used to consult with a wide range of stakeholders, including sector leads, business representative groups, leading professional firms and a variety of lenders operating in the HotSW region.

A significant finding was the pace of change in the finance ecosystem over the period of the Covid 19 pandemic (since March 2020), which has seen the UK government borrowing at levels last seen in 1946 (£303bn in period April 2020 to March 2021). National debt was 97.7% of GDP at the end of that period. In addition to the Covid 19 pandemic the economy has suffered from uncertainty due to the EU transition.

ONS report 6th May 2021 reported a fall in exporting services across a broad range of sectors, with transportation the worse affected. The total proportion of service trading businesses reporting that they have exported or imported in the last 12 months increased slightly from 64% and 69% in June 2020 to 68% and 74% respectively in April 2021. June 2020 must be remembered as a time when the UK was in the teeth of the pandemic and overall trading levels were subdued.

EXECUTIVE SUMMARY

A wide range of Government interventions have played a significant role in supporting the ecosystem, including Furlough, Government backed Loan Schemes, Grants, changes in legislation and the March 2021 budget. However the biggest single influence is the behaviour of the Covid 19 virus and in 2021 the progress of the vaccination program in the UK and overseas. SME confidence and the financial ecosystem has been changing weekly, sometimes daily, and this looks set to continue for the foreseeable future.

Against the back drop of unprecedented uncertainty our findings show the incredible resilience of South West SMEs, which is reflected across the UK.

SME businesses across all sectors account for 99.6% of the business population and produce one half of UK private sector turnover, according to the Federation of Small Businesses. There are around 5.8 million of them, employing 16.6 million people (60% of total UK employment) and generating £2.2 trillion (52%) of UK GDP. In HotSW SMEs account for 99.8% of the total business population (LIS research).

The number of SMEs in HotSW that are borrowing has increased to c60% (from 40% 2019) according to BBB Small Business Finance Markets report 2020/21. 69% of firms had external debt as at August 20 compared to 56% a year earlier.

EXECUTIVE SUMMARY

In this survey 23% Small businesses expressed concerns about repaying their debts overall rising to 37% within the hospitality and leisure sectors which are prevalent in HotSW.

Start up Loans delivered £126M of new lending in 2020 up 41% on prior year and a record. Demand for Sulp remains very strong in the first half of 2021.

The BBB Small Business Finance Markets report 2020/21 states that lenders balance sheets and capital ratio's are in a strong position to support SMEs with finance in 2021 and beyond. However our findings show the supply of SME finance is impacted significantly by the reducing number of banking personnel to deal with the needs of SMEs, especially face to face relationships for Micro and even small businesses.

As at May 2021 all the "Big 5 High Street banks" have, or are going through, major restructuring in their commercial teams (businesses with turnover up to £6.5M and debt size <£1M). Significant numbers of FTE are being refocused on remediation of AML / KYC. High street banks have been largely focussed on existing customers and government schemes, this has left a significant gap for emerging businesses to access finance

EXECUTIVE SUMMARY

Interviews with regional banking leaders suggests that between 20%- 30% of commercial banking managers are in the course of being effectively removed from day to day relationship management.

Our findings demonstrated that lack of local, face to face, relationship management was a significant blocker to obtaining finance for businesses. This was particularly so in or around the third sector and our growing technology sector. In both sectors networking and peer groups are emerging where participants are able to talk with decision makers from businesses like their own.

Tech South West is a particularly good example of self help and peer to peer networking. Tech South West Daily is a website that facilitates sharing of best practise, thought leadership and good news stories. The third sector is less distinct in it's own right and in many ways it cross cuts other sectors.

Against the context outlined above, various survey results discussed in more detail within the body of this report and interviews with key stakeholders across HotSW, a number of access to finance related issues for SMEs have been clarified. Many of the issues are not new but the impact and significance has been amplified by the economic and health climate.

EXECUTIVE SUMMARY

Considering the above points we consider the key issues for HotSW SMEs can be summarised as follows:-

1. Lack of diversity of lenders is limiting choice and history has shown that this issue will worsen if the economy struggles and/or losses from Government backed loan schemes are seen.
2. SMEs have proven reluctant to use the wide range of support from the Growth Hub and professional firms when raising finance. There has been an apparent lack of appreciation of the net benefit in doing so.
3. Leaders in micro businesses, tech & not for profit SMEs benefit from peer to peer networking and there is a strong demand for this in HotSW.

In response to the three areas of concern above we have put forward six solutions for consideration. Some of the solutions are within the gift of the HotSW LEP and partners to deliver and others will require collaboration and support from other stakeholders.

Recommended solutions for consideration are as follows:-

- Creation of a new “Access to Finance” networking platform based on the successful Tech South West Daily website.
 - hosted by the South West Growth Hub
 - facilitate the exchange of knowledge, good news stories and increase awareness of potential solutions to access to finance issues
 - the new website could be income generating for the Growth Hub.
- Creation of a database of lenders active in the HotSW, arranged by purpose of lending,
 - outline of parameters used by individual lenders
 - this would be useful collateral to upload to the website above.
- Quarterly access to finance meetings for senior leaders in the financial sector in HotSW.
 - Hosted by BBB and/or HotSW LEP.
 - Aim is to understand current challenges and points of difference / USP’s focusing on issues rather than lenders.
 - Chatham House rules apply and care needed reference competition law. Outputs fed into website above.

EXECUTIVE SUMMARY

- HotSW LEP to proactively support the development of new regional focused financiers:
 - including Angel funds, financial organisations and/or HNW groups
 - Increase awareness and reach
 - Increased supply breeds increased competition
 - Increased “boots on ground” shown to have impact
- Develop a regional fund with the purpose of providing cashflow friendly, non equity funding.
 - Non voting ordinary shares which could pay a coupon and are redeemable at the behest of the SME rather than investor.
 - Coupon could include some form of profit share as well as interest.
 - Needs to be tax efficient for all parties. Likely to require collaboration with neighbouring LEP's as BBB have indicated they'd like a fund c£100m to make it 'worthwhile'.
- Alongside the regional fund, carve out some bespoke money to provide a top slice to the Start Up Loans Programme from £25k to £50k in HotSW and maybe similar geography to regional fund mentioned above.

EXECUTIVE SUMMARY

In summary our recommended solutions are a mixture of actions the HotSW LEP can take in the short term and are within its gift. Some of these will require working with existing regional partners. There are longer term opportunities based on increased collaboration with BBB to develop bespoke funds, which will take more time to plan and deliver.

The access to finance climate is changing rapidly and there are enough areas of concern that compel the LEP to action and protect the future of as many SMEs as possible whilst creating a culture which encourages and supports greater levels of entrepreneurship.

Discussions with all stakeholders demonstrates a willingness to change and collaborate for the benefit of the HotSW SME population. In addition to the recommended solutions above which are within the HotSW regions gift there is a stated willingness by government agencies, specifically the British Business bank, to work with the region to develop a bespoke fund or funds.

Significant opportunities are available and we recommend the HotSW LEP takes the lead in developing and delivering them.

GLOSSARY OF TERMS

- **SME** – Small, Medium Enterprises – defined 0-250 employees or Turnover <£45M
 - Small business – 0-49 employees or turnover <£6.5M
 - Within small Micro business – 0-9 employees and turnover <£2M
 - Medium business – 50-249 employees or turnover £6.5M to £45M
 - Note definitions using turnover can vary and until 31/12/20 were based in Euros
- **BBB** - British Business Bank
- **BBLS** – Bounce Back Loan Scheme – 100% Government backed (closed 31/3/21) – max £50k
- **Big 5 High Street Banks** – Barclays; HSBC; Lloyds; Nat West & Santander
- **CBILS** – Coronavirus Business Interruption Loan Scheme – 80% Government backed (closed 31/3/21) – max £5M
- **FSB** – Federation of Small Business
- **HotSW** – Devon & Somerset; including Plymouth and Torbay
- **LTV** – Loan to valuation of the asset taken as security by a lender
- **ONS** – Office for National Statistics
- **PE** – Private equity investor
- **RLS** – Recovery Loan Scheme – 80% Gov. backed (6/4/21 closes 31/12/21) – max £10M
- **Super deduction** – tax break on certain asset purchases (1/4/21 – 31/3/24)
- **VC** – Venture Capital – a form of private equity funding

Isca Ventures LLP

Isca Ventures LLP is an ICAEW member firm and limited liability partnership registered in England and Wales with registered number OC368334.

Exeter Office: ESP, Babbage Way, Exeter, EX5 2FN
Bristol Office: Dirac Crescent, Emersons Green, Bristol BS16 7FR
London Office: 90 Paul Street, London, EC2A 4NE

www.iscaventures.co.uk

Information in this document is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Isca Ventures LLP accepts no responsibility for loss arising from any action taken or not taken by anyone using this material.