BRITISH
BUSINESS
BANK

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FOREWORD

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From energy to engineering, transport to training, the UK's 5.5m smaller businesses operate across every conceivable sector and come in all shapes and sizes. They make up the overwhelming majority of the nation's businesses, employ millions of people and are responsible for almost half of private sector turnover. Their success helps to fuel economic growth, and each business will have different funding requirements as they develop and grow.

The diverse finance needs of our smaller business community, however, have not always been reflected in the provision and take-up of available finance options. Historically the market provided a relatively limited choice and depth of options for funding. While this provision has improved recently, there remains a deficit in the use of varied finance by smaller UK businesses to achieve their ambitions.

As the UK's national economic development bank, we were created to improve finance markets so they better serve smaller businesses, enabling them to fulfil their growth potential. Increasing the diversity of both supplier and product on offer is a key part of our mission, measuring our success against an objective that over 75% of our stock of finance is facilitated through providers other than the four largest banks.

We have an increasingly strong record of delivering such change. In the last financial year (2016-17), 94% of the finance we support was delivered out with the 'Big Four', a rise from 79% in our first year of operation (2014-15). We believe that matching smaller businesses up with finance options that better match their needs will ultimately help them, and the UK economy, develop more quickly, more effectively and more strongly.

Our programmes currently support over £3.4bn of finance to UK smaller businesses and we participate in a further £5.8bn of finance to UK small mid-cap businesses. Since our creation in 2014, we've championed a host of alternative debt providers, such as challenger banks, private debt providers, peer to peer debt finance, asset finance, merchant cash advances and other fintech-enabled platforms.

The British Business Bank is also the largest UK-based investor in UK venture capital, helping to close the 'equity gap' for businesses looking to grow rapidly. Our Enterprise Capital Funds programme, currently supporting 24 early-stage funds, has a total investment capacity approaching £1bn.

Our record is strong, but there is still more to do. Crucially, smaller businesses' awareness of their full range of available finance options remains relatively low. That's why the British Business Bank continues to work with its partners to increase awareness, understanding and confidence amongst UK smaller businesses about the growing range of finance choices, particularly through our Business Finance Guide.

This report provides an interesting and informative overview, examining the complexities around how diverse markets for finance can benefit UK smaller businesses. I look forward to working with our partners to explore the issues further and to deliver greater choice in the market.

EXECUTIVE SUMMARY

Diversity in finance markets is created by the mix of products used, the range of finance providers available and the array of funding sources enabling these products and providers. New technology (often known as FinTech) is increasing competition and introducing innovative new business models to the market. It is also helping established finance providers improve the diversity of finance available to small businesses and to adapt their own service models to the benefit of their customers.

Increasing the diversity of finance options for smaller businesses is important for a variety of reasons which together should lead to more optimal outcomes both for individual businesses and the overall economy:

- It can improve access to finance for a wider range of smaller businesses. This aspect is particularly important at different points in the credit cycle. The credit crisis of 2008 and the years following highlighted the problems of relying on a small number of large financial institutions, with consequent implications for macroeconomic stability;
- It can improve the terms and ease of use of finance available to smaller businesses; and
- It can improve the appropriateness of the finance available to smaller businesses, improving the prospects that firms find the form of finance best suited to their needs.

All of these factors can help improve the outcomes for smaller businesses, whatever their stage of development and ambitions, and ultimately leave the UK economy stronger.

The British Business Bank will continue to grow the number and range of new delivery partners, helping to increase the diversity of finance providers. Examples during 2016 include the addition of new asset finance providers and debt funds in our Investment Programme, and an expansion of the eligibility criteria for our EFG and ENABLE programme to include asset finance providers and peer-to-peer lenders respectively. Many British Business Bank programmes retain significant capacity to add additional delivery partners or increase funding through existing delivery partners.

INTRODUCTION

The OECD described an effective financial system as one that can supply financial resources to a broad range of companies in varying circumstances and channel financial wealth from different sources to business investments.[1] During the financial crisis the effectiveness of the UK smaller business finance markets came under strain and the supply of finance to smaller businesses reduced significantly. During the crisis, this was partly a cyclical issue, but structural issues in the supply of finance to SMEs have long been identified by successive government reports. A recent example is the Retail banking market investigation by the Competition and Markets Authority (CMA).[2]

The financing requirements of smaller businesses is a particularly important issue in the UK, where 99.9% of UK private sector businesses are smaller businesses that employ 0-249 people, and these enterprises account for almost half of private sector turnover and 60% of all employment.

The British Business Bank's aim is to make finance markets work better for smaller businesses in the UK at all stages of their development: starting up, scaling up and staying ahead. To help us achieve this aim we have four key objectives:

1. We will increase the supply of finance available to smaller businesses where markets don't work well.
2. We will create a more diverse and vibrant finance market for smaller businesses, with a greater choice of options and providers.
3. We will build confidence in the market by increasing smaller businesses' understanding of the options available to them.
4. We will achieve this whilst managing taxpayer resources efficiently and within a robust risk management framework.

This report presents a framework that captures the different aspects of diverse finance markets and how they impact on smaller businesses use of finance.

CURRENT SMALL BUSINESS FINANCE MARKET CONDITIONS

Use of external finance by smaller businesses includes those who use financial service providers and those using trade credit. Core debt products such as bank loans, overdrafts and credit cards remain the most frequently used.

A clear trend has emerged of fewer smaller businesses using core products since 2012. Applications for new debt facilities fell to 4% of smaller businesses in the first half of 2017 (down from 11% in 2012) with the fall seen across a range of SMEs, from start-ups to older businesses and those specifically looking to scale-up. In part, these changes reflect the wider economic environment noted earlier; they may also be due to a change in preferences, where smaller businesses generally prefer holding positive bank balances and funding growth plans from their own resources.

Despite this, at an aggregate level, flows of finance to smaller businesses again grew in 2016 (Figure 1). Notably, after several years of contraction, net flows of bank loans (new loans, excluding overdrafts) were positive with nine consecutive quarters totalling £5.5bn through to Q4 2016. Asset and asset based finance grew healthily through 2016, with hire purchase in particular well above pre-financial crisis levels. Gross flows of lending to business via marketplace lenders reached £1.3bn in 2016, but they remain relatively small in comparison to sources of debt finance from banks.

One feature of SME finance has been the significant increase in flows of equity finance to smaller businesses over the last five years, though 2016 did however see a decline following a very strong 2015. The EIF has made a significant contribution to UK SME finance markets, committing €2.3bn in equity and €438m in guarantees and securitisation directly into the UK over the period 2011-15.[3] This activity supports scale-up businesses and the Bank will monitor closely market developments in this area.

FIGURE 1

ESTIMATES OF THE FLOWS & STOCKS OF EXTERNAL FINANCE FOR UK SMES £ BILLIONS [a]

		2011	2012	2013	2014	2015	2016
Bank lending stock Source: Bank of England	Outstanding Amount (b)	189	176	166	167	164	166
Bank lending flows	Net flows (c)	-	-6	-2	-2	2	3
Source: Bank of England	Gross flows (d)	-	38	43	53	58	59
Other gross flows of SME Finance							
Private external equity investments		1.28	1.49	1.53	2.31	3.58	3.42
No. of reported deals Source Beauhurst (e)		462	706	972	1309	1408	1148
Asset finance flows Source: FLA (f)		11.4	12.2	12.9	14.4	15.8	16.9
Peer-to-Peer Business Lending flows Source: AltFi Data (g)		0.02	0.06	0.2	0.59	1.01	1.31

a) The information contained in this table should be viewed as indicative as data and definitions are not directly comparable across different sources. There can be some double counting across estimates in different parts of the table. Flows data are cumulative totals for the year or to the date stated. Non-seasonally adjusted. All numbers are in billions and have been rounded appropriately.

b) Movements in amounts outstanding can reflect breaks in data series as well as underlying flows.

c) Net flows does not always reconcile with change in stock due to differences in statistical reporting. The reported stock can include other adjustments made by banks but not detailed when reported, whereas flows data does not include these adjustments.

d) Data exclude overdrafts and covers loans in both sterling and foreign currency, expressed in sterling. The total may not equal the sum of its components due to rounding.

e) Beauhurst is a market data provider that records visible equity deals including crowdfunding deals.

f) The Finance & Leasing Association (FLA) whose members make up 90-95% of the market. Data obtained from FLA Asset Finance Confidence Survey. SME asset finance is assumed to represent 60% of total asset finance in 2011 and 2016.

g) Figures do not represent the entire market. Data obtained from AltFi Data.

GAPS IN THE SUPPLY OF FINANCE REMAIN

While credit conditions have undoubtedly improved, British Business Bank analysis indicates that structural imperfections persist in specific areas of the market across the UK and regional distribution of some products is uneven. Some of these problems apply to smaller businesses at all stages of development, whether they are a start-up, scale-up or seeking finance to stay-ahead.

There is evidence that applications are still turned down due to factors that are symptomatic of an information asymmetry between prospective lender and borrower.[4] This suggests that potentially viable finance requests are still not receiving funding.

In addition, there are smaller businesses that are deterred from applying for finance, despite identifying a need for it. This suggests that information asymmetries also impact the demand for finance. As such the first question for many SMEs is simply can they get finance?

STRUCTURE

The rest of this paper is divided into two sections. The first provides the substance of a framework that we will use to analyse diversity with the following headings: who, where, when, what and how smaller businesses access finance. The second summarises the initiatives the British Business Bank are either directly responsible for, or involved with, to promote diversity of finance and support a range of market participants.

Across each section, we look at the impact of diversity within products, providers, and where applicable sources of finance (Figure 2). Products cover 'core' products, term loans, overdrafts and credit cards, and alternative products which is everything else such as asset finance and mini-bonds. Providers refer to those companies offering these products such as established high street banks, asset finance houses and monolines. Finally, source of finance is defined as where the provider gets its funding from. For example, P2P lenders may receive funds from various sources such as private individuals or institutional investors.

FIGURE 2

TYPOLOGY OF ADDITIONALITY OF DIVERSITY OF FINANCE

Who has access (turnover)	• Finance reaches subsets of SMEs that cannot access mainstream finance and/or for whom mainstream products are not suitable or relevant	New Product
	• Can be driven by different risk appetite or different qualifying requirements	New Provider
Where can finance be accessed (turnover)	• New provider supplies a type of finance to SMEs in a region where that type is otherwise rare/unavailable • Can be driven by a different approach to decision-making, e.g. decentralisation	New Provider
What terms is finance accessed on (terms)	• Increased competition improves terms (including duration and repayment) for some finance	New Product
	• Can be driven by better suitability of a form of finance to the needs of subsets of SMEs	New Provider
When access can be arranged (benefits)	• SMEs can access finance faster, or more conveniently than they could otherwise	New Product
	• Can be driven by differentiated business models or product features	New Provider
How access is delivered (benefits)	• SMEs access finance that comes with ancillary business benefits that are not otherwise available	New Product
	• Can be driven by indirect impact on finance economics	New Provider

SECTION 1:

WHO, WHERE, WHEN, WHAT AND HOW

WHO

Who refers to which smaller businesses can access finance at any given time or through the credit cycle. External finance is important at all stages of SME development including start-up, scale-up and stay-ahead businesses, and can be used for everything from working capital to investment in fixed assets. Ultimately finance helps to preserve or create jobs and wealth for the UK economy. Without external finance these businesses become heavily reliant on savings, friends and family for finance. This is not an option for many and can mean stagnation or failure.

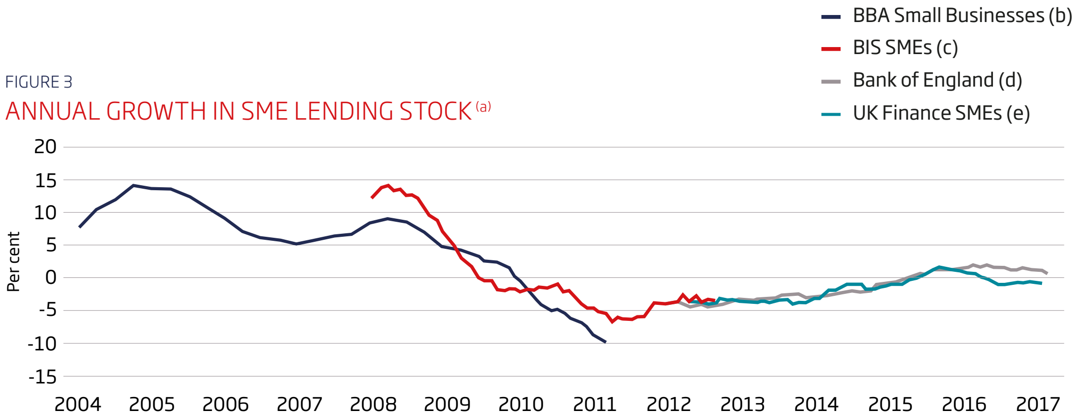
FOR AN SME TO GET FINANCE THERE MUST BE A PRODUCT AVAILABLE THEY QUALIFY FOR…

The greater the range of available products, the more likely an actively searching and financially sophisticated smaller business will be able to find finance. Taking the example of a young business, it may struggle to get access to core products as they often require a demonstrable track record.

However, these firms may be able to receive finance via alternative products with different qualifying criteria (see annex: MDIVE). For example, funding based on the value of specific assets may be available. They may also be able to take equity, rather than debt, where the investors can accept higher risk in exchange for potentially greater returns.

FIGURE 3

ANNUAL GROWTH IN SME LENDING STOCK [a]



a. Rate of growth in the stock of lending. Non seasonally adjusted.

b. Lending by seven UK lenders to commercial businesses with an annual bank account debit turnover of up to £1 million. The growth rate prior to September 2009 is presented on a quarterly frequency and monthly thereafter. Sterling. The survey terminated in June 2011.

c. Source: monthly BIS survey and Bank calculations. Lending by four UK lenders to enterprises with annual bank account debit turnover less than £25 million. Data cover lending in both sterling and foreign currency, expressed in sterling terms. The survey has been terminated.

d. Lending by UK monetary financial institutions to UK SMEs with annual debit account turnover on the main business account less than £25 million. Data cover lending in both sterling and foreign currency, expressed in sterling and are to February 2014.

e. Lending by a BBA panel of lenders to SMEs in Great Britain. SMEs are defined as businesses with turnover up to £25 million. Data cover lending in both sterling and foreign currency, expressed in sterling and are to December 2013.

The diversity of products available can be particularly important during adverse credit conditions. For example, a smaller business that had previously qualified for a particular product may no longer do so. Assuming the product is still available, this could be due to either changes to the qualifying criteria of that product, or the smaller businesses' own circumstances and its prospects against a worsening economic outlook. During the recent financial crisis bank lending to smaller businesses reduced significantly for both overdrafts and term loans (Figure 3).[5]

Whilst some of this reduction will have been demand driven, evidence suggests banks reduced their appetite to lend and tightened the qualifying criteria for many products.[6]
In response, larger firms became active issuers of corporate bonds and shares in 2009 as they sought to reduce their reliance on bank finance (Figure 4).[7] For those smaller businesses that required external finance during this period the ability to access alternative finance products will have been crucial. For many unable to access finance it will have led to reduced growth or may have resulted in them ceasing trading (Figure 5).

BUT IT IS NOT AS SIMPLE AS JUST HAVING LOTS OF DIFFERENT PRODUCTS AVAILABLE IN THE MARKET...

The British Business Bank has consulted with several challenger banks, a catch all term for those banks outside of the largest UK banks. Many challenger banks do not compete with the big banks on price, but on service and product, and this is partly driven by the fact they do not have access to the volumes of low cost funding, predominately from current accounts, that the larger banks have.

Using the example of asset finance, once affordability has been established, the big banks often underwrite using probability of default, whilst some challenger banks look more at loss given default. This leads to different asset finance products being offered by the two types of provider. This focus on loss given default, which is an asset focused measure rather than a borrower focused measure, means a different cohort of smaller businesses are potentially eligible for asset finance products offered by challenger banks.

Furthermore, some specialist or niche markets are seen as too small or too complex for larger, multi-product providers to offer a product at all.

This is because the resources they would need to spend creating an appropriate product would be disproportionate to the potential returns and volumes. For other providers with different cost structures, however, there is potentially enough return that it is profitable for them to offer a product that provides access to finance for the impacted smaller businesses.

Having a diverse range of providers can also increase stability within finance markets. Providers from the same industry or sharing key characteristics can be adversely impacted by a single market event. The 2008 financial crisis highlighted systemic risks within the banking system, with banks across Europe and the USA suffering losses and struggling to access their traditional market funding sources.

Following the crisis, lending conditions were further impacted by stricter regulations around capital adequacy. Smaller business lending attracted a high risk-weighting in the adequacy calculations which decreased margins and reduced lending to the heavily bank lending reliant smaller business sector.[8] Having more diverse providers within the smaller business finance market, willing and able to lend significant amounts, and as non-banks, not impacted by the same capital adequacy requirements, could in the future limit the impact on smaller businesses.

In the US, where SMEs are less reliant on bank lending, the economy returned to growth much quicker than the UK and many European countries. It has been argued the greater diversity of finance provider in the US meant SMEs could access finance more readily during what was essentially a banking crisis.[9] Partly for this reason, creating a more diverse set of finance providers and deeper capital markets is not only the aim of the British Business Bank but also for pan European bodies.[10]

BUT, IT IS NOT AS SIMPLE AS JUST HAVING LOTS OF DIFFERENT PROVIDERS ACTIVE IN THE MARKET...

As noted by Haldane & May in 2014, modular configurations in nature and engineering prevent contagion infecting the whole network in the event of nodal failure. The same principles apply in banking and finance systems.[11] Diversity in smaller business finance products, smaller business finance providers and in their ultimate funding sources, can not only serve a wider range of smaller businesses in a wider range of circumstances, but can also enhance the stability of the smaller business finance market.

FIGURE 4

PNFC NET ISSUANCE £ BILLIONS

Source: Bank of England

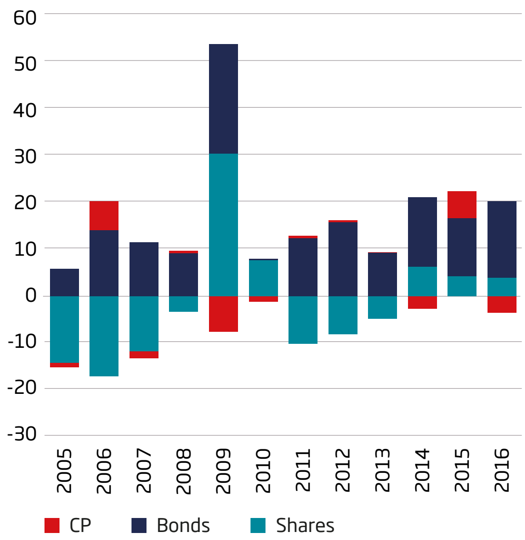


FIGURE 5

UK COMPANY BANKRUPTCIES

Source: ONS

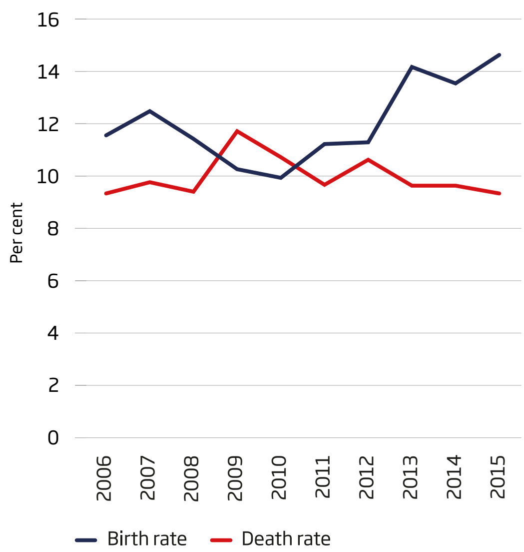
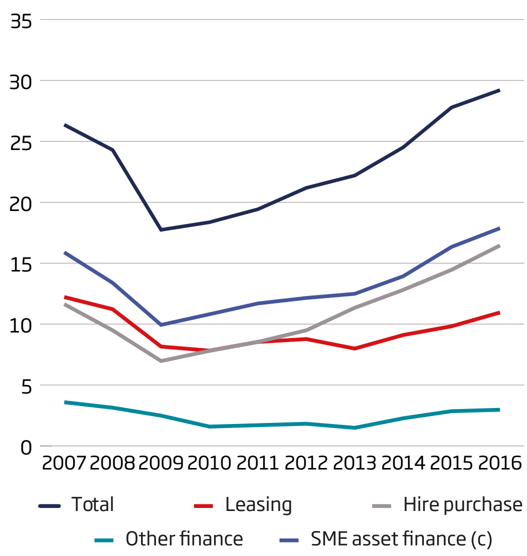


FIGURE 6

SIZE OF UK ASSET FINANCE MARKET FOR BUSINESSES 2007-2016 - NEW BUSINESS £ BILLIONS[(a) (b)]

Source: Finance & Leasing Association (FLA)

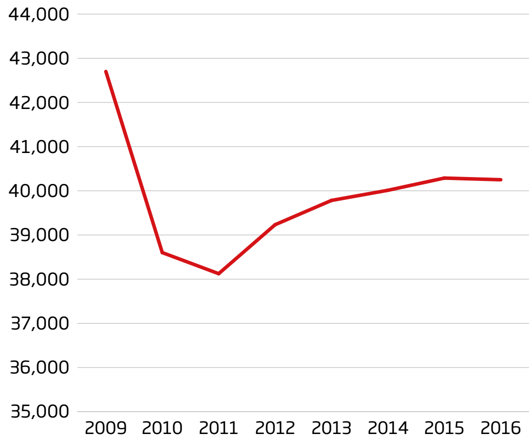


a. Asset finance new business for deals of up to £20 million.
b. 2007-2011 SME figures estimated as 60% of total asset finance new business excluding high value transactions of £20 million or more and public sector finance.

FIGURE 7

NUMBER OF SMALLER BUSINESSES USING ASSET BASED FINANCE IN THE UK

Source: Asset Based Finance Association (ABFA)



Despite diversity of supply in the retail provision of asset and asset based finance to SMEs, volumes of lending from asset and asset based finance providers also reduced significantly between 2007 and 2009 (Figures 6 and 7).

A contributing factor to the constrained supply is likely to have been the degree of concentration in the sources of funding for asset and asset based finance providers. Knock-on effects are caused by reliance of asset and asset based finance providers on funds from wholesale lenders, such as banks.[12] This is particularly the case for many mid-sized to smaller non-bank providers of asset and asset based finance. Therefore, if an asset finance provider cannot get funding, adverse banking conditions can impact the supply of credit from non-bank finance providers as well.

This suggests that, like in nature, difference in finance markets can promote resilience. When a shock such as the global financial crisis hits, if firms have different business models, including different approaches to raising funds, they are affected in different ways, potentially reducing the systemic impacts. Truly diverse sources of funding can also give a finance provider more options when designing their products.

In some cases, alternative funders can support products that would otherwise simply not exist. These products can include grants funded by public sector bodies or charities. They are provided via delivery partners with the aim of improving access to finance for those sectors, regions or demographics seen as underserved by traditional SME finance markets.

An example of this is the Start Up Loans programme. This is funded by the Department for Business, Energy and Industrial Strategy and is delivered by The Start Up Loans Company, a subsidiary of the British Business Bank. It aims to encourage entrepreneurship in the UK, increase the rate of business creation and improve survival prospects. More specifically, the programme offers loans (up to £25,000) alongside free mentoring and support to individuals who are starting a new business or who have been trading for less than two years (see annex: The Yorkshire Meatball Company).

WHERE

The above 'who' sections refers to the characteristics of the SME such as its age, sector and business model. A further variable that needs to be taken into account is **where** an SME is based. This is because access to finance products and providers is not consistent across the UK with uneven regional distribution. For seemingly near identical companies, where they are based has a significant impact on the type of finance and the finance providers they access.

Bank lending broadly matches the business population in most English regions, although some, such as the South East, have proportionately lower share of lending by value and volume (9%) compared to the share of businesses in the region (16%). This may be due to the availability and accessibility of alternative sources of finance in the region, such as equity.

Conversely, fewer equity deals occur for smaller businesses located in regions outside of London and the South East. As a result, a much smaller number received equity given the population of businesses in these regions (Figure 8) and SMEs in this region are more reliant on bank lending and thus more exposed to bank lending credit cycles than SMEs in London and the South East.

London received the greatest amount of equity funding (47% by deal number, 56% by investment amount) in 2016, yet the region accounts for 20% of high growth businesses.[13] This may suggest equity deals are underrepresented in other regions relative to the share of high growth businesses. Potentially one of, or a combination of, three factors are creating this uneven regional distribution of equity; either SMEs in certain regions are less aware of equity and its benefits, these SMEs are less aware of providers of equity, or there are fewer equity providers in these regions.

In a recent British Business Bank survey, businesses in London indicated greater awareness of equity based finance such as venture capital and business angels. In comparison, businesses in the North of England and the Midlands showed higher awareness of government/local government grants.[14]

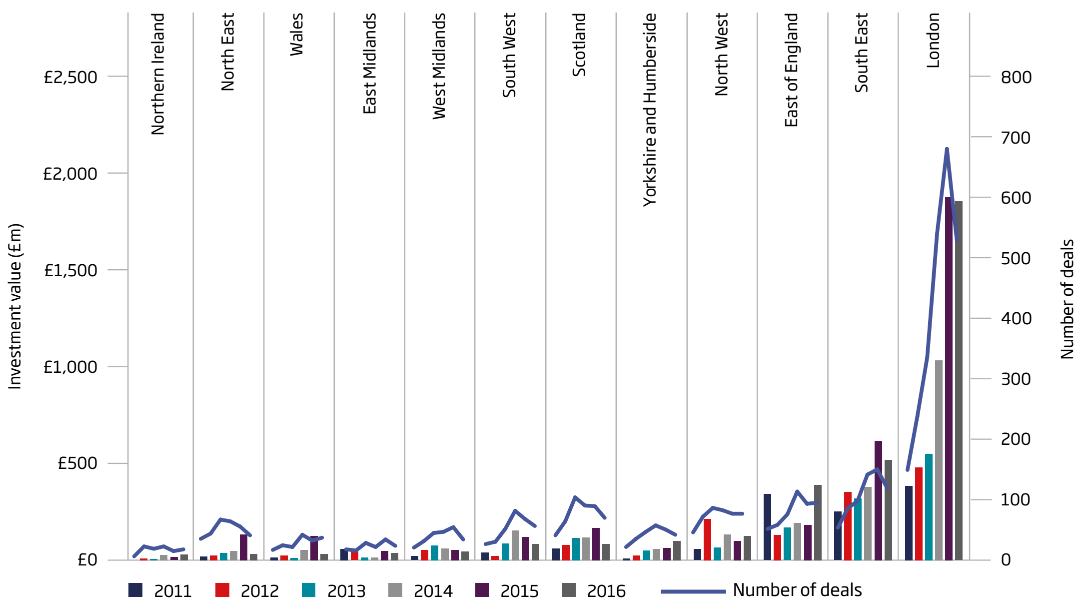
Mirroring this awareness, private equity, venture capital and crowdfunding investors were involved in more than half of equity deals in London (52%). In the North East, local and regional government were involved in more than half (53%) of equity deals, whilst in the North West they were involved in 46% of deals (see annex: Relative Insight).

As discussed in the previous section, increasing awareness of, and providers of, equity and other underutilised finance products increases the types of SMEs that can access finance. In regions outside of London and the South East this appears to be even more important and would also result in other benefits discussed later in this paper.

FIGURE 8

NUMBER AND VALUE OF DEALS BY ENGLISH REGION AND DEVOLVED ADMINISTRATION

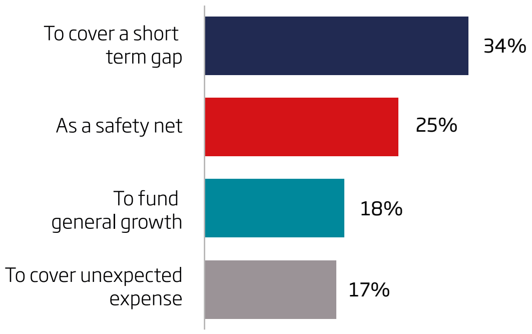
Source: British Business Bank analysis of Beauhurst



WHEN

FIGURE 9

MOST COMMON REASONS FOR SEEKING WORKING CAPITAL



Source: British Business Bank 2016 Business Finance Survey - Ipsos MORI
Base: all seeking finance for working capital, n=304

For some smaller businesses who have established they can access finance, the next question is **when** they can get it. The need can result from the failure of a supplier or customer, an unexpected cost or inaccurate financial planning. It may also arise for positive reasons like an unexpected new order or opportunity (Figure 9).

The quickest way to access formal funding is usually via an overdraft, use of a credit card or line of credit from a supplier. These are only quick if they are already in place, meaning many smaller businesses will not have finance available to them when they need it in a hurry. This is sometimes given as a reason why SMEs maintain cash reserves, if they can.

For many forms of finance there is often a time lag between applying and receiving finance due to non-standardisation, i.e. a bespoke response and/or product is required, or because of due diligence requirements. Regardless of cause, the end result may mean that an SME cannot get finance fast enough to meet their needs, which is effectively no access to finance at all.

HOWEVER, THERE ARE PRODUCTS WHERE A DECISION CAN BE MADE WITHIN DAYS AND FINANCE CAN BE DELIVERED TO THE SMALLER BUSINESSES QUICKLY...

One example is an asset finance loan. This differs from traditional financing, as the borrowing company must offer some of its assets in order to quickly get a cash loan. The lender only needs to worry about identifying and valuing the asset that is being financed and then securing title. Once these steps have been taken the lender can often provide finance within days.

WHILST THE NATURE OF SOME PRODUCTS CAN INFLUENCE THE SPEED OF FINANCE AVAILABILITY, THE SAME CAN BE THE CASE FOR FINANCE PROVIDERS, EVEN FOR THOSE OFFERING CORE PRODUCTS...

WHAT

For an SME who needs finance in a hurry, some established lenders may take too long to make a decision and/or deliver significant amounts of finance. Whilst a business' main bank potentially has most of the data it requires to make a decision on a finance request, it may still require the SME to resubmit documentation and information. This could be due to compliance rules or because they are unable to utilise the data due to legacy technology and processes.

Some peer-to-peer (P2P) lenders can provide responses to initial term loan applications within hours, and a loan can be deliverable within days. They can achieve quick decisions by making one or more changes to the traditional face-to-face models prevalent in banks. P2P lenders are typically online orientated, which can be particularly helpful for applicants who do not have the time to attend an appointment during business hours, and use technology to streamline their processes. (see annex: Laird of London)

Rather than investing their own funds, P2P lenders typically match borrowers and investors and make money from fees charged to the borrower and/or from commission on the interest received by the investors. For these firms, it is a business model based on the flow of new loans. As such, many P2P lenders' systems are built for speed to aid the flow of new loans and maintain this point of difference.

Once a smaller business has ascertained that they can access finance within the timeframe they require, the next question is often on **what** terms they can get that finance. Terms cover not just the headline cost, but also the duration of the finance, collateral requirements and any other conditions or restrictions imposed once an agreement is in place. If the price or the terms (such as collateral requirements) of the finance are too high, this can lead to SMEs either turning down the finance or it can offset some or all the value of receiving the finance.

THE PRESENCE OF A DIVERSE RANGE OF PRODUCTS SHOULD NOT RESULT IN IMPROVED TERMS PER SE BUT...

In consumer theory, substitutes are products that a consumer, in our case an SME looking for finance, perceives as similar or comparable, meaning they would require one or the other rather than both. Formally, X and Y are substitutes if, when the price of X rises, the demand for Y rises.

It is difficult to argue differing finance products are perfect substitutes, but it is easier to argue that they can be used for the same purpose. For example, overdrafts, invoice finance and certain P2P products may be competing for some of the same customers. However, whilst there is evidence of differing products impacting each other's terms in the consumer finance markets, evidence of diversity of product improving the terms available in the small business finance markets is hard to find.[15]

HOWEVER, IT IS CLEARER THAT GREATER DIVERSITY OF PROVIDER CAN LEAD TO IMPROVED TERMS FOR SMALLER BUSINESSES VIA TWO MAIN CHANNELS...

The first channel is competition. In the absence of market imperfections, competition should bring about efficient outcomes. With competition, the market mechanism works by encouraging new providers or products to enter more profitable market segments, driving out excess returns or terms, while also driving out firms that are operationally inefficient or unable to innovate.

Nearly every non-monopolistic market, financial or not, has at some time witnessed competitors attempting to increase profit, market share or to drive out competition via offering better terms.

Competition based on price has most commonly been seen at the low risk end of the smaller business financial markets and amongst larger providers. A previous report noted a number of companies in the asset finance space indicated that prices offered to businesses had reduced in recent years by 2-3%, because of intense price competition due to the lower cost of borrowing and the volume of available cheaper funding.[16]

Elsewhere, such as with business banking for and bank lending to SMEs, there are market imperfections and competitive forces are weak. SMEs' low or imperfect levels of knowledge and limited shopping around mean price and terms competition is limited within retail banking.

Many initiatives, such as those set out by the CMA in the Retail banking market investigation, aim to make it easier for smaller businesses to compare available products and through the provision of better information, increase competition in smaller business finance markets.[17] One such initiative is called Open Banking. Open Banking uses Application Programming Interfaces (APIs) to share information securely, without you having to reveal your password, thereby reducing the 'friction' costs of searching and applying for finance. Amongst other uses, apps could use this information to find and compare deals for your business accounts and loans.

In addition, the CMA is also improving the information available on loan prices and eligibility. The CMA is requiring lenders to publish their prices for smaller, non-complex lending products, drawing on approaches used under the existing personal consumer credit regime. The largest banks will also be required to develop online tools which allow small businesses to input some information about themselves and receive tailored indications of eligibility and price for lending products. This is designed to encourage lenders to compete both on price and on their willingness to make loans.

The effect of the CMA's package of remedies is that smaller businesses will be more empowered and will enjoy the benefits of more competitive finance markets, whilst enabling providers to compete more fairly for customers.

The second channel is via innovation. When deciding what to offer a potential customer, a provider will take into account many factors. Key drivers are internal factors like their own cost of funding, their business model, incentives, risk appetite and skillsets. The combination of these can lead to innovation and improved terms on existing products. Over time these innovations can pass from the original innovator to other market participants as ideas are dispersed.

In recent years, FinTech or tech enabled finance providers have entered SME finance markets bringing new, more efficient or cost effective technologies and processes to well established finance products with some successfully gaining market share from the established providers. Several established finance providers, including the larger UK banks, have either partnered with or bought FinTech or tech enabled finance providers to adopt these innovations into their own products and services, often improving the price or terms they are able to offer.

As noted by Frame and White (2014) "the centrality of finance in an economy and its importance for economic growth (e.g., Levine 1997) naturally raises the importance of financial innovation – and its diffusion. Since finance is a facilitator of virtually all production activity and much consumption activity, improvements in the financial sector will have direct positive ramifications throughout an economy. Further, since better finance can encourage more saving and investment and can also encourage better (more productive) investment decisions, these indirect positive effects from financial innovation add further to its value for an economy."[18]

HOW

A further consideration can be **how** a smaller business applies, receives or pays for funding. This can impose real restrictions on access to finance for some, and represent the difference between deciding whether to seek and/or accept finance. Technological developments, such as the rise of the app, and the low interest rate environment have led to innovations for both borrowers and funders.

FOR SOME SMALLER BUSINESSES, THE OPPORTUNITY TO NOT ONLY RAISE FINANCE BUT ALSO ENGAGE DIRECTLY WITH THE INVESTOR IS VERY APPEALING...

Crowdfunding is a way in which people and businesses can try to raise money from the public to support a business, project, campaign or individual. It can take several forms including donation-based, pre-payment or rewards based, loan-based or investment-based crowdfunding with the latter two typically FCA regulated.

Over the past few years, a significant number of companies, ranging from start-up restaurants to established department stores, have issued mini-bonds as a way of securing debt-based finance. Mini-bonds can offer flexibility in payment terms and investor interaction not usually available to an issuer in more traditional funding markets.

Several high-profile deals have used payment in kind - such as gift boxes or instore discounts - instead of, or at least partially replacing, the monetary payments usually associated with more standard bonds. Not only can this be cheaper for the issuer, but it can also be a way of engaging with their investor and customer base in much the same way equity crowdfunding can. It potentially encourages investors to become regular customers and advocates for the brand, or turns their customer base into loyal investors.

As well as the flexibility in payments and scope for enhanced interaction with investors, mini-bonds also offer a further benefit to the issuer. Mini-bonds cannot be traded and are not listed on any market. As such, the regulatory requirements are much less stringent than for listed bonds. This can reduce the set-up costs, in terms of both time and fees for the issuer. However, as they are less regulated, they could potentially require a greater amount of knowledge and due diligence on the part of a prospective retail investor to ascertain whether a specific mini-bond is a suitable investment.[19]

HOW A SMALLER BUSINESS ENGAGES WITH ITS PROVIDER CAN BE JUST AS IMPORTANT...

This may be due to a variety of reasons, including something as simple as having a branch conveniently located for the SME. For the smaller or less financially sophisticated SMEs, a relationship with their finance provider(s) can involve a significant amount of business support. This can be driven by familiarity, a need for guidance or simply convenience and both traditional providers and several newer challenger banks offer a branch based approach.

The opposite case can also be true. SMEs may require a provider with an excellent online offering, via an app or website, due to an inability or unwillingness to go to a branch and/or time constraints. It could also be because they know what they want, when they want it and simply need it delivering in the most convenient and efficient manner.

Phone banking was first launched in 1989 and online banking in 1997. Now, following the smartphone and app revolution, new digital banks are offering online only propositions using either proprietary technology or a "bank in a box" approach. The ultimate aim for some of these digital banks is to provide a summary of an SME's financial products on a single screen and automated financial advice to help the SME make quicker and smarter financial decisions and then execute these decisions in the simplest most efficient manner.

Whilst not finance providers in themselves, finance platforms can be very beneficial for SMEs who might not know what type of finance is available to them or which finance providers are out there and/or are time constrained. The SME however, may be financially sophisticated enough to understand their options, if presented to them in an easy to access format.

The ability to search multiple products and providers quickly and easily via a single process can be very useful for time constrained SMEs. Many finance platforms offer the SME an opportunity to fill in one set of questions in an attempt to work out what finance the SME requires and which products and providers from their panel of lenders may be the best fit (see annex: Fork Truck Borders Instructions LTD).

IMPLICATIONS

Every small business and every circumstance is different, meaning there is no one size fits all product or provider. As described above, a potential myriad of factors need to be considered when deciding which finance option is the most appropriate for any given small business at any given time. If an SME chooses an inappropriate finance product or provider, it can lead to restrictions on their future growth potential.

Indeed, the recent British Business Bank Business Finance Survey highlighted the wide range or reasons that drive smaller businesses when choosing a provider. Chart 8 highlights that there is no one size fits all funding solution.

EVEN IF A PRODUCT HAS THE LOWEST PRICE, THE MOST APPEALING TERMS OR IS SIMPLY THE EASIEST TO GET, IT DOESN'T NECESSARILY MEAN IT IS THE MOST APPROPRIATE PRODUCT FOR A SMALLER BUSINESS...

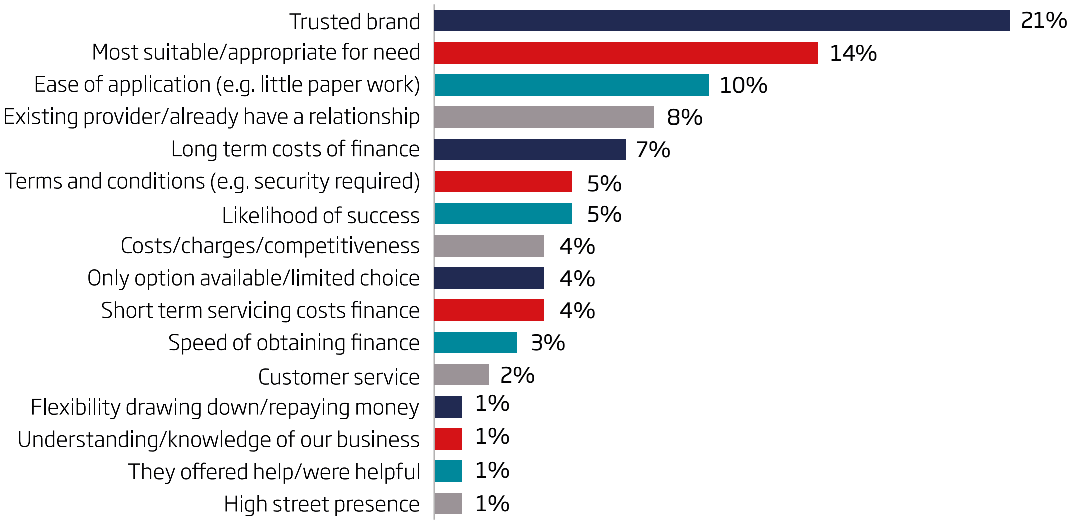
Bank lending is the most common source of external finance for many smaller businesses to fulfil their start-up, cash flow and investment needs, but traditional bank finance may not be the most appropriate to certain types of businesses. In particular, this can pose a challenge to newer, innovative and fast growing companies, with a higher risk-return profile. Because these may represent equity rather than debt risk, these firms may be better suited to alternative forms of finance.

A British Business Bank report further explored the difficulties faced by growing smaller businesses when looking for finance.[20] It found that senior debt providers typically require collateral and that high growth businesses can soon exhaust their available collateral. In addition, interest payments on senior debt can constrain the cash flow available for investment at growth orientated businesses in the early stages of growth.

FIGURE 10

MAIN REASON FOR CHOOSING A FINANCE PROVIDER

Source: British Business Bank 2016 Business Finance Survey - Ipsos MORI
Base: all SMEs that contacted only one providrer (n=461 in 2016). Multicode, unprompted.



Growth loans, used to support business growth and development, are bespoke debt-based finance that goes beyond senior debt in terms of its risk appetite and higher pricing. Growth loans include a variety of debt funding solutions including unitranche, mezzanine, subordinated debt, junior debt and second lien. These are typically unsecured or the security is subordinated behind senior lenders, or is based on intangible assets like patents and other intellectual property.

For other SMEs debt may not be the solution at all. Equity financing - where cash is injected and, if motivated by an exit strategy, without the expectation of regular payments coming out of the business' cash flow - can be more appropriate for such companies. Seed and early stage equity finance can boost firm creation and development, whilst other equity instruments can provide financial resources for growth-oriented and innovative SMEs.

IN SOME CASES A PARTICULAR PROVIDER MAY BE MORE APPROPRIATE FOR A SMALLER BUSINESS...

For some smaller businesses, their choice of finance may be as much about the provider as the product. Dragons Den is a high-profile TV example which offers entrepreneurs the chance to secure equity investment. But many of the entrepreneurs that go on the show are not there because it is the cheapest or easiest route to finance. In addition to the cash on offer to successful applicants, they hope to benefit from the exposure, expertise and contacts that being on the show can offer.

This isn't limited to TV shows; many equity investors and venture capital companies contribute value over and above simply supplying funds. They are often led by individuals or management teams with a track record in growing and building a business in a sector and deep networks. For some smaller businesses, this advice and access to partners or customers can be more valuable than the finance itself (see annex: EDISIX).

ADVICE WITH OR WITHOUT ACCOMPANYING FINANCE CAN BE IMPORTANT...

Advice can be particularly important in areas where the smaller business has limited expertise within the company to address specific issues. Research has highlighted the importance of professional advice and the related positive impacts it can have on smaller businesses' performance.[21] Accountancy is often highlighted as the most sought after external advice. For business owners and management, awareness of the choices available allows the business to make well-informed financing and planning decisions. For others access to an adviser or funders' network or contacts can be a key driver of success.

In addition, recent assessments of the needs of fast growth firms suggest that supporting sustained growth requires a holistic model that combines the development of the business with the development of the capabilities of the firm's leadership team. Moreover, advice that builds capability within the firm is likely to require a face-to-face interaction because of its greater breadth of impact on a wider set of aspects of the firm's operations and behaviour. Professional advice when focussed on a company's need works – and more intensive advice works better.[22]

SECTION 2: HOW THE BRITISH BUSINESS BANK IS PROMOTING DIVERSITY OF FINANCE

The British Business Bank and its subsidiaries, including its commercial arm British Business Investments (BBI), support a diverse range of product offers and finance providers. The aim is to increase the choice of finance products and providers for smaller UK businesses and the number of smaller UK businesses that can access finance and thus deliver the benefits to SMEs and the wider economy as discussed in the previous section.

The Bank invests through market participants rather than lending directly to SMEs. One of our main ways of increasing diversity is to support new entrants and increase the capacity of existing lenders across the scope of the finance markets.

- Across the bank and its subsidiaries, in 2015–16 we partnered with challenger banks as part of our ENABLE Guarantee programme and participated in tier two debt issuance.
- We supported asset finance providers through our programmes (ENABLE Funding and the Investment Programme) and are looking at introducing an asset finance variant for Enterprise Finance Guarantee.
- We also supported some types of finance that are less well established as options in the UK finance markets in 2015–16, including merchant cash advances and debt funds – a type of finance well-established in the USA but relatively new to the UK marketplace.

Together, this activity has meant that the Bank now works with over 100 partners to deliver its debt and equity programmes. Figure 11 shows a high-level summary.

This section looks at a selection of programmes that the Bank and its subsidiaries offer.

FIGURE 11

JUST SOME OF THE STORY SO FAR...[23] THE BRITISH BUSINESS BANK INVESTS IN A RANGE OF WAYS TO CREATE A DIVERSE SMALLER BUSINESS FINANCE MARKET

Asset and Asset Based Finance
- £140m via Investment Programme
- Awards of £239 through ENABLE
- New EFG variant launched

Challenger Banks
- £60m of structured capital through BBI
- First Challenger bank partner for H2G
- 7 Challenger banks partner via EFG

Debt and Equity Funds
- BBI has awarded £287m to 9 debt funds
- 24 ECFs with £938m of investment capacity
- £32m to 71 companies via Angel CoFund

FinTech and Tech-enabled
- £135 via Investment Programme
- £30 to 8 FinTech companies via VC Catalyst
- New Enable variant launched

CHALLENGER BANKS

Support for challenger banks is delivered through four main channels: Enterprise Finance Guarantees, ENABLE Guarantees, Help to Grow and through BBI's Investment Programme.

The Enterprise Finance Guarantee (EFG) is a guarantee scheme to facilitate lending to viable businesses that have been turned down for a loan or other form of debt finance due to inadequate security. EFG provides the lender with a government-backed 75% guarantee against the outstanding guaranteed balance. In instances such as this, EFG may be able to turn that decline into an acceptance.

Since its launch in 2009, EFG has supported the provision of £2.9bn of business loans to 28,000[24] smaller businesses in the UK (Annex: Case study). Included in these figures EFG has supported £300m of loans to SMEs via 16 challenger banks.

ENABLE Guarantee is designed to encourage additional lending to smaller businesses by improving the capital efficiency of a finance provider's SME lending portfolio. Participating banks are incentivised by a government-backed portfolio guarantee to cover a portion of a designated lending portfolio's net credit losses in excess of an agreed 'first loss' threshold, which they receive in exchange for a fee. ENABLE Guarantee is particularly suited to and can boost the competitiveness of banks using the standardised model and engaging in lending to businesses attracting a higher risk-weighting in the capital requirements calculations compared to an internal risk based model.

ENABLE Guarantees are available to all UK banks and UK branches of foreign banks which lend, or intend to lend, to viable small and medium-sized enterprises operating in the UK.

Funding challenger banks is a relatively new area of focus for BBI's **Investment Programme**. The first investment was completed in 2015 when £30m was provided to Shawbrook Bank. This was part of a £75m Tier 2 note issuance with BBI participating alongside private sector investors. The purpose of this subordinated facility was to enable Shawbrook to increase its lending book which supports our mandate of increasing both volume and diversity of lending for SMEs. A second Tier 2 commitment in the form of a facility for Atom Bank has since been completed.

THE ABOVE PROGRAMMES HAVE SIGNIFICANT CAPACITY TO ADD ADDITIONAL DELIVERY PARTNERS OR INCREASE FUNDING VIA, ALONGSIDE OR IN EXISTING DELIVERY PARTNERS. CHALLENGER BANKS ARE ENCOURAGED TO CONTACT THE RELEVANT TEAMS (SEE WEBSITE) FOR FURTHER DETAILS OR TO DISCUSS POTENTIAL NEW OR BESPOKE SOLUTIONS.

ASSET AND ASSET BASED FINANCE PROVIDERS

The Bank and BBI support asset and asset based finance providers through three main channels; ENABLE Funding, EFG and the Investment Programme.

ENABLE Funding is aimed at improving the provision of asset and lease finance, as well as P2P lending, to smaller UK businesses. Providers of finance to smaller businesses often lack the scale required to access capital markets – a key source of funding for lending institutions – in a cost-efficient manner.

ENABLE Funding warehouses newly-originated finance receivables from different originators – bringing them together into a new structure. Once the structure has sufficient scale, it will refinance a portion of its funding on the capital markets. This means the British Business Bank can help small finance providers to tap institutional investors' funds.

The first ENABLE Funding transaction was a £100m facility for Hitachi Capital UK to fund a portfolio of newly originated small business asset finance receivables. The European Investment Fund guarantees 50% of the facility. Since the first transaction in September 2015, there has been a further three transactions worth £139.4m and the programme as supported lending to around 5,890 enterprises.[25]

Asset Finance is an area where BBI's **Investment Programme** has been very active in the past. Until recently, independent asset finance providers found accessing capital to be used to meet the needs of smaller companies challenging. To date BBI has committed £140m to 6 Delivery Partners.

However, the nature of the capital constraint has changed as senior funding, typically from banks, has returned to the sector driving down prices for mainly larger, Tier 1, borrowers. What now appears to be restricting asset finance for smaller, especially Tier 2 borrowers, is the capital structures of the Asset Finance Providers themselves, which may be in need of additional equity funding or junior debt. For this reason, in 2016 BBI provided a number of structured solutions, mezzanine capital combined with senior debt, to asset finance providers directly.

IN ADDITION, THE BANK IS CURRENTLY ACCREDITING PARTNERS FOR AN ASSET FINANCE VARIANT OF EFG. THIS VARIANT IS AIMED AT HELPING ASSET FINANCE PROVIDERS TO SUPPORT VIABLE BUSINESSES WITH EITHER INTANGIBLE OF DIFFICULT TO VALUE ASSETS, SUCH AS INTELLECTUAL PROPERTY OR NICHE AND/OR CUTTING-EDGE TECHNOLOGY, OR WHO MAY BE ABLE TO SERVICE THE DEBT BUT DO NOT HAVE SUFFICIENT UP-FRONT CASH OR SECURITY FOR A DEPOSIT.

THE ABOVE PROGRAMMES HAVE SIGNIFICANT CAPACITY TO ADD ADDITIONAL DELIVERY PARTNERS OR INCREASE FUNDING THROUGH EXISTING DELIVERY PARTNERS. ASSET FINANCE PROVIDERS ARE ENCOURAGED TO CONTACT THE RELEVANT TEAMS (SEE WEBSITE) FOR FURTHER DETAILS OR TO DISCUSS POTENTIAL NEW OR BESPOKE SOLUTIONS.

FINTECH AND TECH-ENABLED

The Bank and BBI support FinTech, including P2P lenders, companies through three main channels; ENABLE Guarantees, the Investment programme and the equity programmes.

The Bank and BBI make direct commitments through a number of venture capital funds. The VC Catalyst funds have provided early stage equity of £30m to eight FinTech companies across the wider FinTech ecosystem, whilst the ECF and Angel CoFund programmes have also invested in the sector.

BBI has been an early supporter for the nascent P2P and tech-enabled lending community. To date £135m is committed to five FinTech alternative lending Partners.[26] These partners cover a wide range of products including P2P term loans, invoice finance and merchant cash advances (Annex: Scaramouche & Fandango).

IN NOVEMBER THE BANK UPDATED THE ENABLE FUNDING REQUEST FOR PROPOSALS IN ORDER TO OPEN UP THE PROGRAMME TO PEER-TO-PEER LENDERS THAT FACILITATE THE PROVISION OF FINANCE TO SMALLER BUSINESSES. THIS MEANS THE BANK CAN NOW HELP PEER-TO-PEER LENDERS TAP INSTITUTIONAL INVESTORS' FUNDS.

FURTHERMORE, BBI RECOGNISES THE IMPORTANCE OF FINTECH IN FOSTERING INNOVATION AND ENHANCING COMPETITION IN UK FINANCE MARKETS, BECOMING A GROWING SOURCE OF FUNDING FOR SMALLER BUSINESS, AND CONTINUES TO ASSESS OPPORTUNITIES IN EXPANDING OUR SUPPORT TO THE SECTOR.

FINTECH FINANCE PROVIDERS ARE ENCOURAGED TO CONTACT THE RELEVANT TEAMS (SEE WEBSITE) FOR FURTHER DETAILS.

DEBT AND EQUITY FUNDS

The British Business Bank has an important role in increasing diversity of funding options, not only by investing across all the above finance providers but also via debt and equity funds.

The **Investment Programme**, building on the Business Finance Partnership, has been instrumental in supporting the emergence of new SME focused debt funds in the UK market. The programme has committed £287m to nine SME focused debt funds, with supported funds offering a range of debt types in the sub £20m loan market ranging from senior secured loans to mezzanine and unitranche debt, so that borrowers are able to access growth capital that is appropriate to their needs.

On the equity side **Enterprise Capital Funds (ECFs)** are commercially managed funds that combine private and public money to make equity investments in high growth businesses. The ECF programme aims to increase the supply of equity finance to businesses seeking smaller amounts of venture capital finance, and are affected by the identified "equity gap" where private sector VC funds tend not to operate.

The ECF structure offers an attractive return structure designed to be competitive with other investment opportunities encouraging greater investment into this part of the market. The programme aims to lower the barriers to entry for new fund managers looking to operate in the VC market, by backing new emerging management teams. The ECF programme is a significant part of the UK venture capital industry with 24 funds to date with over £938.1m of funding (including third party) being committed through the Enterprise Capital Funds programme, of which £551.5m is from the British Business Bank.[27]

IF YOU ARE A NEW FUND MANAGER, OFFERING PRODUCTS RANGING FROM SENIOR SECURED LOANS TO MEZZANINE AND UNITRANCHE DEBT OR EARLY TO LATE STAGE EQUITY FUNDING, AND ARE INTERESTED IN WORKING WITH THE BANK OR BBI PLEASE CONTACT THE RELEVANT TEAMS (SEE WEBSITE) FOR FURTHER DETAILS OR TO DISCUSS POTENTIAL NEW OR BESPOKE SOLUTIONS.

REGIONAL ACCESS

As noted earlier, access to certain types of finance is uneven around the UK. To help address the regional issues the bank, in partnership with Local Enterprise Partnerships (LEPs), has set up the **Northern Powerhouse Investment Fund (NPIF)** and the **Midlands Engine Investment Fund (MEIF)**. NPIF and MEIF will produce greater levels of investment, increase the focus on the potential opportunities across the Northern Powerhouse and Midland Engine regions and provide increased flexibility in the type of funding provided.

NPIF will provide over £400 million of lending and investment directly to smaller businesses to boost economic growth and productivity in the Northern Powerhouse. The Bank is investing £50m of its own capital into the new fund, which is being matched by an additional £50m from the European Investment Bank. The Bank has worked with LEPs from the North West, Yorkshire & the Humber and Tees Valley, and with the Department for Communities and Local Government to aggregate the European Regional Development Fund money they receive for the LEP areas into a combined fund. Bringing allocations together into larger funds allows more resources to be targeted at businesses with growth potential across a wider area, with economies of scale meaning more money can be invested directly in smaller businesses.

Similarly, the £250m MEIF is a joint agreement between the bank and eleven LEPs in the East & South East and West Midlands and is expected to bring together legacy funding from existing programmes, new funding from the Bank and new European funding.

FOR FURTHER INFORMATION PLEASE GO TO THE PROGRAMMES SECTION OF THE BANK WEBSITE.

AWARENESS

The measures above are all designed to improve the supply and diversity of supply of finance. However, that is only one side of the equation. Recently it has become clear awareness of and demand for many types of finance has been relatively low.

To address awareness The Business Finance Guide – a journey from start-up to growth - has been devised for businesses and advisers by the bank and the ICAEW Corporate Finance Faculty. Supported by a further 21 major professional, membership and representative organisations, this includes several tools and ideas to help businesses consider their options, make decisions and plan how they will finance expansion. It is a unique guide that sets out the main things to consider and outlines sources of finance available to businesses – ranging from start-ups to smaller businesses and growing mid-sized companies (Figure 12).

The Business Finance Guide draws on the considerable expertise of its many contributors, who together represent more than a million members in businesses, finance providers and advisory firms and organisations.

In addition, the potential role for finance platforms to raise awareness of alternative finance options has been highlighted by new regulations supported by the bank. Since the 1st November 2016, if a smaller business is unsuccessful in securing finance from any of the participating banks, the bank will automatically offer a referral to the government designated finance platforms. If the referral is accepted by the smaller business the bank will pass on the smaller businesses' details and the designated finance platforms will attempt to match them with alternative finance providers on their lending panel.

THE BANK IS IN THE PROCESS OF DEVELOPING A COHESIVE STRATEGY TO EFFECTIVELY TARGET SMALLER BUSINESSES WITH RELEVANT FINANCIAL INFORMATION. THE GOAL IS TO INCREASE ECONOMIC ACTIVITY. THIS WILL BE ACHIEVED IN TWO MAIN WAYS: BY INCREASING THE CONFIDENCE OF SMALLER BUSINESSES TO APPLY FOR EXTERNAL FUNDING AND TO ENSURE THAT WHEN THEY DO, THEY RECEIVE THE MOST APPROPRIATE PRODUCTS.

FIGURE 12

WHAT ARE YOUR FINANCE OPTIONS?

	EQUITY OPTIONS							DEBT OPTIONS							
	Seed finance	Angel finance	Equity crowdfunding	Venture capital	Corporate venutre capital	Private equity	IPO/public offering	Start-up loan	Overdraft	Bank loan/Bond	Peer-to-peer lending	Asset-based finance*	Leasing & hire purchase	Export or trade finance	Growth finance
What stage is your business at?															
Pre-trading	●							●							
Pre-profit	●	●	●	●	●			●	●			●	●	●	●
Profitable and growing		●	●		●	●	●		●	●	●	●	●	●	●
Established and growing		●	●			●	●		●	●	●	●	●	●	●
Established and stable							●		●	●	●	●	●	●	
Established and stressed						●			●	●		●	●	●	
What future plans, challenges or opportunities are most important in your business right now?															
Initial funding	●	●		●	●			●							
Launch product/ services/brand			●		●		●	●	●	●		●			●
Organic sales growth					●				●	●	●	●		●	●
Expand into new UK markets or areas					●	●	●			●	●	●		●	●
Expand internationally					●	●	●			●	●	●			
Invest in new facilities						●	●			●	●		●		
Refinance/reduce cost of borrowing			●							●	●	●	●		
Need capital restructuring			●							●	●	●			
Improve cash position			●									●	●		●
Acquisition plans						●	●					●			

SUCCESS STORIES

Edesix and Panoramic Growth Equity

You have proved the concept and are making early sales. But unless you press the accelerator, your market will move faster than you. How are you going to finance your next big move?

Seasoned technology entrepreneurs Richie McBride and Robin Iddon had self-funded their Edinburgh-based body-worn camera designer and manufacturer Edesix to the edge of huge growth. Edesix's Video Badge system – which is the size of a credit card – is a personal CCTV for frontline workers.

Having proved the concept and made early sales, attracting interest from police forces, paramedics, parking enforcement teams and bailiffs, they needed finance to fund rapid expansion through investment in R&D and Sales & Marketing.

"We were seeing deals that we were missing out on," says managing director Richie McBride. "We did not want just to grow organically; we had to press the accelerator." "We did look at debt funding because we were a bankable proposition but the banks were not into this type of risk and we were not prepared to put our houses on the line."

Edesix did look seriously at angel funding and made plenty of pitches. There was a lot of interest. But McBride and Iddon felt that this route involved working with syndicates rather than a single investor. "We felt that there were potentially too many masters to please. We wanted to find one single investor with a full range of resources under their roof."

That led them to look at venture capital firms. An introduction to Panoramic Growth Equity came via the Business Growth Fund. Less than six months after being introduced to the company, Panoramic Growth Equity made an initial investment of £750,000 into Edesix, with Panoramic partner David Wilson taking a seat on its Board. They have since invested in further rounds to help Edesix fund expansion into new markets and continue to develop its technology.

McBride says "We met and liked the team – that's important. They have a hands-on style and a collaborative approach: this is important as we were looking for a professional investor to contribute value over and above funding the cheque."

Laird London and Funding Circle

A fleeting opportunity arises to grow your business. If you don't seize it, it will pass. But you need the cash to act decisively - and just at that moment your own cashflow is stretched. So how are going to get the loan you need for your next big step?

Alex and Zofia Torun-Shaw were looking for a creative, niche retail business to begin. The idea of a hat shop was almost on a whim, but it fitted - so to speak. Just before Christmas, the Torun-Shaws had a small trial outlet in east London's trendy Columbia Road. It took off immediately, attracting celebrity customers such as Keira Knightley. Soon they had opened further units, in Covent Garden, the Royal Exchange in the City of London and Soho using funding sourced from a friend.

A few years later, an opportunity came up for another store - this time in Cambridge. In order to secure the property and have it open in the run-up to Christmas, the Torun-Shaws needed to move fast but also needed more money. Their friend-and-lender suggested the peer-to-peer (P2P) lending platform, Funding Circle.

Two factors persuaded them to explore this new route: the friend-and-lender was actively using the platform and, secondly, Funding Circle had received £20m investment through a government investment programme. Since then, the government-owned but operationally independent British Business Bank has invested a further £40m to support further lending to smaller businesses through Funding Circle.

Laird was still a relatively new company; its application to Funding Circle consisted of two sets of year-end accounts plus its management accounts. Within the week, the application had been approved and the loan had been put out to investors. Within eight hours of going live, Laird had raised the funds it required from approximately 200 investors. Its biggest investor put in £2,000, its smallest £20.

"From start to finish, our first experience with Funding Circle was less than two weeks," says Alex Torun-Shaw. "Our bank was still processing our application forms."

It's this speed and convenience that is attractive to many business owners; revealingly, 50 per cent of applications to Funding Circle come outside working hours. With responses to initial application usually within two working days, a refusal is at least a fast "no" and a loan, as Laird discovered, is deliverable within a couple of weeks.

One year later, another property opportunity arose - this time it was the premises next door to Laird's Covent Garden outlet. It would give them greater street frontage in what is a great trading location. They had a four week window in which to secure the deal. Such a chance to expand didn't come at a convenient time because trading was at a pinch-point, with payments going out to suppliers as the autumn/winter stock came in.

"I didn't even go down the bank route this time," says Alex Torun-Shaw. He went straight to Funding Circle and within two weeks had the funds in place. The company paid off its initial loan and doubled the size of its Covent Garden presence.

MDIVE and DSL Business Finance

Your new business begins with a modest amount of capital and a good contract with a large customer. Soon you need to make a significant investment in order to meet the growing needs of your customers - but have you got the financial track record to secure the finance?

Off the coasts of north and west Scotland there are miles of underwater nets for the millions of fish destined for dinner plates. Divers must check regularly on the state of the farm - for holes in the nets of pens, inspecting the moorings and the like, work that the sea farms sub-contract to independent - and usually-self-employed - divers.

With the work being conducted under water out of sight of the customer, it's vital that there's complete trust between the contractor and diver. The sea farm operator Scottish Sea Farms certainly trusted Murdo Smith. It was their support that prompted Smith and his partner Helen Dewar to set up MDive, a commercial diving company based on the Isle of Mull. "We had been talking about it but Scottish Sea Farms gave us the kick up the backside that we needed," says Dewar.

The nascent company had to meet Scottish Sea Farms' exacting standards; for example, it had to conform to quality standard ISO 9001 and subscribe to the RBS Mentor employment and HR advisory service. It was administratively demanding for a couple who had not started a business before, but it meant that MDive started out firmly on the right foot.

Marketing itself as a specialist diving business, MDive immediately set itself apart. Its divers are full-time employees. They wear branded MDive outfits. While their initial funding had come from an investment by a friend, several grants, and the contract with Scottish Sea Farms, it was not long before MDive needed a loan to help it expand.

"We were too reliant on ferries," explains Dewar. "Not only were they a cost to the business but their timetables constrained the number of jobs could we fit in a day and which sites could we reach." MDive needed its own boat. It had to be large enough to store diving equipment such as a compressor and generator and have warm and dry facilities for the divers.

Such a boat was going to cost £80,000. And while the forecasts for the fledgling business looked good, it was still only in its first year. "Our lack of a financial track record was our main struggle. We tried various avenues for funding but were unsuccessful," says Dewar.

Through the Business Gateway, MDive was introduced to Glasgow-based DSL Business Finance. DSL is a not-for-profit lender that provides funding to small to medium sized businesses throughout Scotland, the majority of whom have been declined finance from mainstream lenders.

DSL provides these loans under the Enterprise Finance Guarantee (EFG), a guarantee scheme managed by the British Business Bank to facilitate lending to viable businesses that have been turned down for a loan or other form of debt finance due to inadequate security or a proven track record.

By providing lenders with a government-backed guarantee for 75 per cent of the value of each individual loan, the British Business Bank and the lender share the risk and facilitate loans that would otherwise not take place.

The licence to offer the government's Enterprise Finance Guarantee scheme is extremely important to DSL. "The use of the EFG enables us to be competitive in the marketplace," says Sandra McLean, fund manager at DSL Business Finance. "It also provides us with a degree of security for loan defaults without which we could not function."

Smith and Dewar applied for a loan and were interviewed by a panel. "We thought it was going to be like Dragons' Den," Dewar laughs, "but they could see how passionate about the business we were. We got the nod before we left the building! Both Business Gateway and DSL have been fantastic - they believed in us and have helped us. It was a breath of fresh air that DSL listened to our proposals, took us seriously and helped us turn our plans into reality. "

MDive purchased the boat and apart from saving more than 50 per cent on annual ferry costs, it opened up new markets too. "The boat has been brilliant," says Dewar. "We now do mooring inspections for marine research facilities. We are doing salvage work."

Of course, it is not all plain sailing. Like many small businesses, MDive needs to invest before it can secure and deliver the contracts that will generate cash and build up the business. It needs to recruit more qualified staff. The costs of maintaining the ISO quality standards will remain high. However, they now have the confidence and knowledge of how and where to access alternative sources of funding.

The Yorkshire Meatball Company and Start Up Loans

Established in March 2014 by father-and-son team, David and Gareth Atkinson, The Yorkshire Meatball Co roll their meatballs in Yorkshire, using the freshest and tastiest British meat chosen for its quality and provenance.

A total of £20,000 from the Start Up Loans Company, helped the duo launch their concept – initially in the form of a Meatball and Craft Beer Bar in Harrogate, winning several awards in its first year. Their first restaurant was followed shortly by a second, under a franchise in York.

Towards the end of 2016, early success in the hospitality market was followed by the launch of the first premium-branded meatballs for the retail market – with the company securing contracts with Asda, Tesco and Morrison's

In late-2016, following the rapid expansion of national chain restaurants into the Harrogate hospitality market, The Yorkshire Meatball Co. took the decision to close its restaurant operations to focus resources fully on the retail market. Their meatball products are now available in over 200 stores across the country.

Relative Insight and Maven

The funds in which Northern Powerhouse Investment Fund invests are open to businesses with material operations, or planning to open material operations, in, Yorkshire and the Humber, the North West and Tees Valley. Maven was appointed earlier this year to manage the £57.5m NPIF - Maven Equity Finance, focused on providing flexible equity funding to high-potential SMEs primarily based in the North West, with a focus on supporting their growth aspirations and contributing to regional economic development, job creation and innovation. Relative Insight is a strong example of the ambitious and dynamic businesses NPIF can support across its investment area.

Relative Insight was founded in 2012 after a 10-year research project with Lancaster University's linguistic and cyber security departments, which used language analysis to help law enforcement identify criminals masquerading as children in chat rooms.

Today they apply the same methods to help brands interact and communicate more effectively with their audiences, focusing on comparison of the way people speak to derive insights that fuel sharper strategy and smarter communication. Users of the technology are able to identify golden nuggets of inspiration born out of discovery rather than simply typed into a search bar. The Company's current client base includes Disney, Unilever, Havas and R/GA, and they continue to apply their technology to crime detection.

Ben Hookway, CEO at Relative Insight, added: "The investment from Maven will allow us to ramp up our customer facing operations, accelerate development, and capitalise on the proliferating opportunities in the UK and, increasingly, the USA. Having customers like Unilever and Disney proves that we have a valuable solution and the investment will allow us to scale to new customers."

Martin Clark, Investment Manager at Maven, said: "Maven is very pleased to have secured this investment into Relative Insight and look forward to working with the talented management team, helping them achieve their ambitious growth plans. Relative Insight epitomises the kind of early stage growth business that the equity finance part of the Northern Powerhouse Investment Fund is designed to assist."

Fork Truck Borders Instruction Ltd and Funding Options

Fork Truck Borders Instruction Ltd provides training for forklift trucks and other plant machinery including excavators, dump trucks and cranes.

They wanted to buy a new forklift truck, to employ a new member of staff and expand the business, and applied but were turned down for an overdraft with their existing business bank, even though the business had managed for seven years with no overdraft and they could see Fork Truck Borders Instruction Ltd's business accounts.

Under the new Bank Referrals to Designated Finance Platforms scheme, they were referred to Funding Options within an hour, who passed them on to Iwoca. Iwoca approved their funding (£5,000), and they had the money in their account within 24 hours of being turned down by the bank.

Douglas Younger, Company Director at Fork Truck Border Instruction Ltd, said: "Getting this funding quickly has really helped in a time of need, and now I'm interviewing for staff with the new forklift truck already in place. To buy this equipment urgently, I was in the corner, and it was a real blessing to have the alternative – it was a pleasure dealing with Funding Options."

FOOTNOTES

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23 As of end of March 2017

24 As of end December 2016

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26 as of end of March 2017

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