

# Supporting businesses to start and grow



## The opportunity

The United Kingdom is a success story on business start-ups, ranking 3rd according to OECD research. There were 350,000 new enterprises registered in 2014 and the UK now has a record 5.4 million small businesses<sup>73</sup>. The UK is also one of the world's leading financial centres, and this should be a powerful advantage for British business.

To raise our productivity we need to marry our effective start-up culture with the right support and investment to facilitate the growth of businesses and social enterprises with the greatest potential. The Government can support businesses which want to expand by improving access to capital for growing businesses, through the creation of financial incentives, and by encouraging the creation of networks and institutions that help to connect firms to opportunities to get financing.

Access to bank loans for SMEs has recovered since the recession of 2008<sup>74</sup> – in part as a result of actions by the Government such as the establishment of the British Business Bank.

Equity finance is growing too<sup>75</sup>. Tax reliefs such as the Enterprise Investment Scheme and Seed Enterprise Investment Scheme have also helped encourage the growth of venture capital investment in the UK, so that firms looking to expand can raise equity as well as debt. In 2015 there were a record number of venture investments, and total investment into venture-stage grew by 62 per cent compared to 2014 figures<sup>76</sup>. An increasing number of start-ups

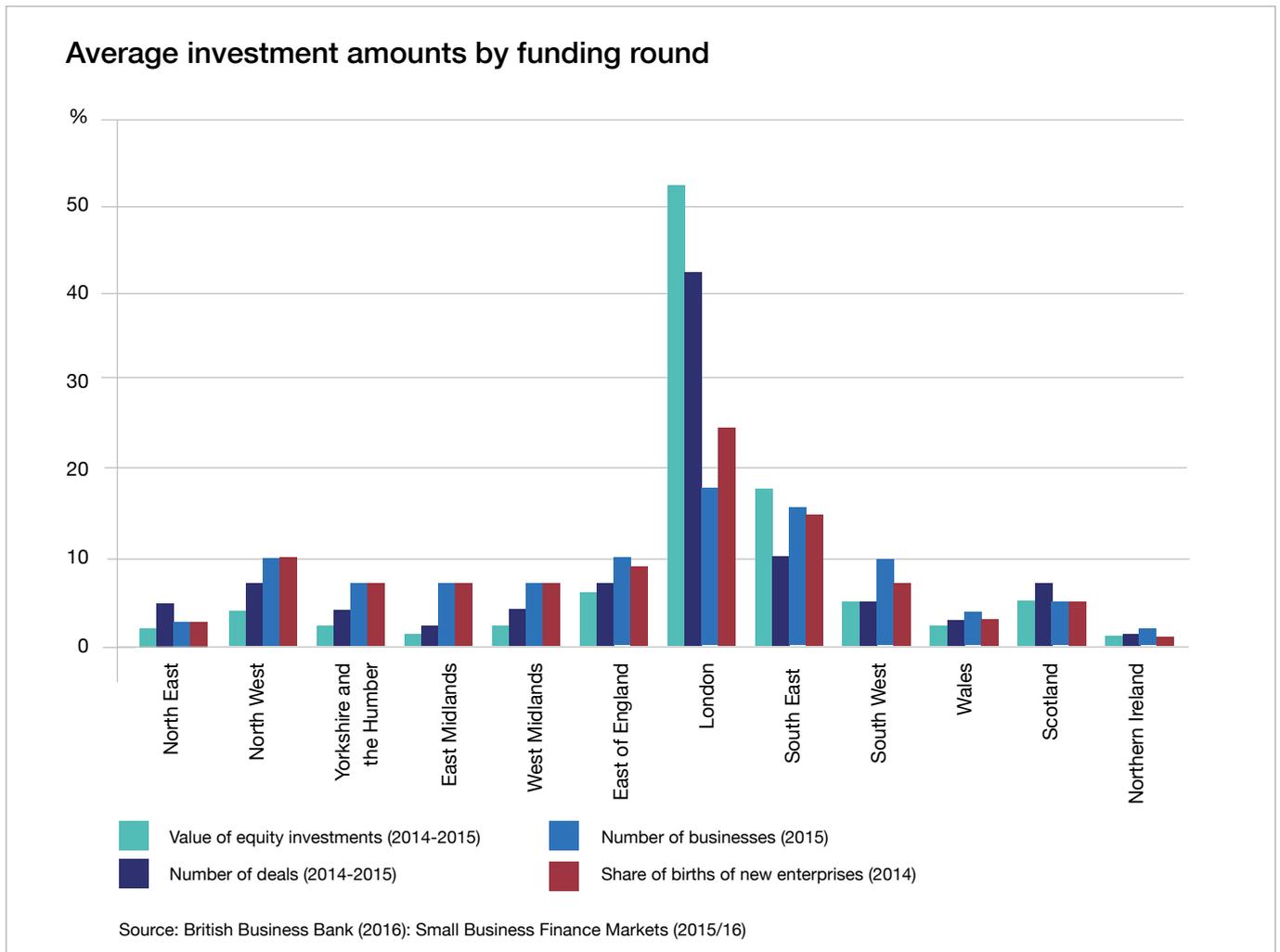
is a positive development, but it will also mean there will be more firms in need of later stage growth funding in the coming years.

Investment in businesses that are growing, and investment decisions by private companies, are fundamentally a role for the market. But the Government can play a catalytic role in establishing and deepening new capital markets. It needs to ensure that regulatory frameworks, tax and fiscal incentives support business investment rather than distort markets. To this end, we are committed to saving businesses £10 billion by improving regulation during this Parliament. We delivered £885 million of this in the first year and have published five of the first round of Cutting Red Tape reviews, engaging with different sectors across the economy, helping to further reduce bureaucratic and regulatory barriers to growth, innovation and productivity.

## The challenge

Though the UK has an excellent record in creating businesses, many of them face barriers to scaling up – including a lack of finance to support growth, their inability to adopt digital processes, and limited access to skills, particularly the leadership and management skills required to scale up successfully.

Larger companies may also face incentives which do not support investment and the long-term decision-making required for growth.



### Access to capital for growing firms, and barriers to scaling up

While we rank third among for start-ups, we rank only 13th for the number of businesses that scale up successfully, according to OECD research<sup>77</sup>. One part of the challenge is about improving access to finance for businesses looking to grow.

Despite the UK’s position as a world leader in financial services, some observers say we have an under-supply of late-stage venture capital for innovative, expanding UK businesses compared to the United States. It is certainly the case that a lower proportion of UK start-ups grow into standalone businesses than in the US. This problem is further compounded by low awareness and take-up of alternative funding

options among SMEs, and a low appetite for equity investment<sup>78</sup>.

There is also some evidence that the supply of equity finance varies between different parts of the UK and is concentrated in London and the South East<sup>79</sup>. New types of funding, such as crowdfunding, appear to be highly concentrated in London and the South East, and are spreading only slowly to other areas.

Scaling up is not just a question of capital. It is also about having the leadership and management skills to make the right decisions for a business. Many UK companies have excellent leadership and management skills, but comparisons with overseas competitors show we lag behind. Organisations with better qualified management and a dedicated

programme of management development have been shown to perform more effectively, and have more sophisticated and higher quality products and market strategies<sup>80</sup>.

We should also recognise that not all businesses will seek to scale up rapidly. Research by the Federation of Small Businesses<sup>81</sup> shows that around half of small businesses are seeking to grow over the next year. Yet only around 10 per cent are seeking to grow their turnover by more than 20 per cent. The majority of those looking to grow are therefore aiming for moderate or steady growth rather than rapid expansion.

In this context, local economic growth strategies should focus not only on high-growth scale-ups, but also on those with more moderate ambitions. Enabling many small businesses to achieve their more moderate goals could have significant economic impact alongside supporting other firms to increase their rapid

growth. The Government provides support for all businesses through a combination of the Business Support Helpline, GOV.UK and the Growth Hub network.

**Long-term investment and incentives for publicly-listed companies**

The UK has lower levels of fixed capital investment than competitors in other countries<sup>82</sup>. The UK has ranked in the lowest 25 per cent of all OECD countries for 48 of the last 55 years and in the lowest 10 per cent for 16 of the last 21 years. It has also invested on average two to three per cent of GDP less than France, Germany and the US.

In practice this has meant the UK has experienced lower investment in assets that drive productivity than other major industrialised countries. For example, the UK has lower take up of robotics and automation technology than competitors.

**Stocks of fixed assets of UK private quoted firms, scaled by profits and turnover (2010)**



Source: Davies, Haldane, Nielsen, Pezzini (2014): Measuring the costs of short-termism

These differences in investment rates can be partly but not wholly explained by differences in the makeup of the UK economy.

Another factor is the incentives large companies in the UK receive. Some commentators have argued that quoted companies and their investors find it more difficult to invest in assets that pay back over the longer term<sup>83</sup>. For example, one study found quoted firms in the UK invest far less in fixed assets than similarly sized private firms<sup>84</sup>.

There is some evidence that incentives in fund management may undermine long-term decision-making as funds are often expected to deliver short-term returns against an industry benchmark. More than two-thirds of respondents to a 2013 survey of European investors by the Chartered Financial Analyst Institute cited short period evaluation cycles by asset owners as an impediment to long-term investing. Fund managers sometimes believe that short term underperformance will result in the termination of their mandates, even when this is not intended by the asset owner<sup>85</sup>.

## Our approach

We are committed to driving business growth and productivity by:

- improving access to finance for businesses looking to grow;
- backing institutions that can catalyse private sector equity investment – particularly in places where this may be more of a problem;
- improving other support for scale-ups and entrepreneurs by building up networks, supporting the business-led Productivity Council, and using government data in a smarter way;
- ensuring the uptake of new technology and digital processes which support growth;
- considering whether any measures need to be taken to promote a more long-term approach to funding.



## Accessing the finance to grow

To understand better where there are barriers to the growth of long-term investment, the Government has launched a new Patient Capital Review, led by the Treasury. The review will be supported by a panel of leading investors and entrepreneurs, chaired by Sir Damon Buffini.

It will:

- consider the **availability** of long-term finance for growing innovative firms looking to scale up;
- identify the **root causes** limiting the availability of long-term finance for growing innovative firms, including any barriers that investors may face in providing long-term finance;
- review **international best practices** to inform recommendations for the UK market;
- consider the role of **market practice and market norms** in facilitating investment in long-term finance; and
- assess what **changes in government policy**, if any, are needed to support the expansion of long-term capital to support growing innovative firms.

The review will publish a consultation document in the Spring and make its final recommendations ahead of the Autumn Budget 2017.

## Backing institutions which can catalyse private sector equity investment

The Government has also taken steps to support the availability of finance in different parts of the country – such as the creation of the British Business Bank (BBB), which is improving access to capital across the country.

Alongside the Patient Capital Review we are increasing investment in venture capital by the BBB by £400 million – to unlock £1 billion of new finance. This will act as a catalyst for the creation of larger funds to support follow-on investments in promising scale-up companies across the UK. The British Business Bank will invest in funds alongside private investors, helping more late-stage venture capital funds to be created.

We are in the process of creating the Northern Powerhouse Investment Fund and Midlands Engine Investment Fund, which add to and aggregate up existing local investment funds, enabling economies of scale and better management.

The Business Growth Fund (BGF) – set up by UK-based banks Barclays, HSBC, Lloyds, RBS and Standard Chartered, and supported by the Government – is another example of the creation of an institution to catalyse private investment. Through its nine regional offices the BGF has successfully invested more than £1 billion into more than 160 growing SMEs since it was founded in 2011, with nearly three-quarters of this funding invested in businesses outside London and the South East. Government will support the continued expansion of the BGF.

Surveys show that new businesses may not be aware of what is available in their area or familiar with how to access it<sup>86</sup>. New models of funding such as crowdfunding are also concentrated in London and the South East. Funding networks have also been weaker outside this area, and we will work with the ScaleUp Institute, the British Business Bank, the BGF and other partners to examine how we might improve business networks and so improve access to capital in the rest of the UK.



### Improving support for scale-ups and entrepreneurs

To help improve management and leadership skills to boost productivity, the Government proposes to work in partnership with Local Enterprise Partnerships (LEPs), Growth Hubs and the private sector to enable the timely delivery of scale-up plans across the country. To achieve this we will take the following actions:

- Recognising the particular challenges faced by businesses scaling up rapidly, the Minister for Small Business will take the role of ‘Scale-up Champion’, working to support high growth scale-up companies across the UK.
- Businesses that are growing fast have unique challenges and can benefit from connections between others in analogous positions. The Government will work with the ScaleUp Institute and other partners, including LEPs and Growth Hubs and their network of strategic partners, including universities, business schools, business bodies, associations, and the private sector to build peer-to-peer business networks specifically for fast-growing firms.
- We will use data that only government has – such as VAT returns – to help identify fast-growing firms at an early stage. This will enable the efficient offer of advice and support to catalyse business growth and support scale-up businesses in cooperation with the Behavioural Insights Team and the ScaleUp Institute.
- A review into entrepreneurship will be led by the Chief Entrepreneurial Adviser at the Department for Business, Energy and Industrial Strategy, entrepreneur Professor Tim Dafforn. This is a newly-created role. The review will assess the support currently available to entrepreneurs and consider international best practice, with the aim of identifying any potential gaps in current policy. It will examine the entire entrepreneurial journey, focusing on the motivations and opportunities for those embarking on business ventures, from education to business development and growth.
- The entrepreneurship review will also examine how to ensure best practice across business schools can reach the widest audience. To-date, Lord Young’s recommendations to increase the impact of business schools in supporting small companies have been implemented. In particular, setting up the Small Business Charter has resulted in 33 business schools being awarded Charter status. The Chartered Association of Business Schools

has helped 4,700 students to find work placements in Britain's micro-businesses and start-up sector. These business schools have also directly helped over 8,000 small businesses and more than 800 new businesses have already been started as a result of the Small Business Charter schools.

### Sharing excellence through peer-to-peer networks

We have announced £13 million of funding support for the business-led Productivity Council in the Autumn Statement, to support stronger business-to-business engagement to improve productivity, including through the appropriate use of digital technologies. This initiative, chaired by Sir Charlie Mayfield, will provide strong and sustained leadership to raise productivity across the business community, offering management training and business-to-business coaching through its specialised productivity academies across the country.

The work of the Council will offer support in understanding the levers to improve productivity at company level, including practical advice for individual businesses. It will help develop a long-term movement to engage businesses seeking to improve their productivity.

### Corporate performance and investment

The Government has published a Corporate Governance Green Paper, which includes options for strengthening the link between executive pay and long-term company performance, and encouraging greater shareholder engagement with corporate decision-making.

Some argue that changes need to be made to the UK's listings regime to further support high growth and innovative businesses. One change which has been suggested is to make it easier

for companies to list with dual class share structures on the UK's listed markets. While these structures are allowed under a Standard Listing, they are not permitted in the Premium Listing regime<sup>87</sup>. Proponents believe that the dual class share structure of companies such as Google, Facebook and LinkedIn, which give their founders enhanced voting rights, have contributed to their success. They argue that these structures allow firms to retain a long-term perspective by insulating founders from short-term market pressures, such as the need to meet quarterly earnings targets.

However, many institutional investors and shareholder representative groups have opposed dual class shares, arguing that they would weaken the UK's high standards of corporate governance and disadvantage minority shareholders.

The Financial Conduct Authority has announced in its 2016/17 Business Plan that it will be reviewing the structure of the UK's listed markets, and it plans to release a discussion and consultation paper in the first quarter of this year. This review will discuss whether changes to the listing regime are desirable to enable it to continue to provide appropriate access to capital for issuers, while maintaining the UK's high standards for investor protection. With the increasing internationalisation of capital markets, this discussion will include a consideration of whether the broader listing regime might accommodate more effectively significant foreign listings that may have different corporate governance structures without affecting the UK's high standards of market integrity and investor protection. The review will also seek to explore how the UK's primary markets can further support the provision of patient capital to the science and technology businesses that are crucial to the long-term success of the UK.



## Supporting businesses to start and grow

### Actions under way:

- We have established **the Patient Capital Review** which will assess how the Government can help growing innovative firms obtain the long-term ‘patient’ finance that they need to scale up.
- We have invested **an additional £400million in the British Business Bank** to catalyse later stage venture capital investments by the private sector.
- We have committed to provide **£13 million of funding for the Productivity Council, over three years**. The Council will provide strong, sustained leadership and business-to-business advice to raise productivity across the business community.
- The Government has published a **Corporate Governance Green Paper**, which includes options for strengthening the link between executive pay and long term company performance, and encouraging greater investment by firms.

### New commitments:

- We will work with the British Business Bank to **build understanding of the obstacles to firms accessing capital outside London and the South East**, and the supply and demand-side causes of lower rates of equity deals.
- **The Minister for Small Business will take on a new role of Scale-Up Champion**, overseeing a task force to support high growth scale-up businesses across the UK and to build peer-to-peer business networks to improve productivity, working with Local Enterprise Partnerships, Growth Hubs, the ScaleUp Institute and other partners.
- We will explore **how data – such as that held by HMRC and Companies House – can be used to identify scale-up businesses** and be made available to enable local public and private sector organisations to better identify, target and evaluate their support to scale-up businesses more effectively.
- We will continue to **build on the success of the British Business Bank, and will work with the Business Growth Fund (BGF) and other private partners** to raise awareness of equity funding, diversify funding streams and increase the supply of finance for growing businesses.

- We will explore how we can **support the development of B2B ratings and feedback platforms** to make it easier for SMEs to determine the quality of business advice and support services provided to them by other firms.
- A **review into entrepreneurship** will be led by the Chief Entrepreneurial Adviser at the Department for Business, Energy and Industrial Strategy. The review will assess the support currently available to entrepreneurs and consider international best practice with the aim of identifying any potential gaps in current policy.

## Questions for consultation

18. What are the most important causes of lower rates of fixed capital investment in the UK compared to other countries, and how can they be addressed?
19. What are the most important factors which constrain quoted companies and fund managers from making longer term investment decisions, and how can we best address these factors?
20. Given public sector investment already accounts for a large share of equity deals in some regions, how can we best catalyse uptake of equity capital outside the South East?
21. How can we drive the adoption of new funding opportunities like crowdfunding across the country?
22. What are the barriers faced by those businesses that have the potential to scale-up and achieve greater growth, and how can we address these barriers? Where are the outstanding examples of business networks for fast growing firms which we could learn from or spread?