Business, Innovation and Skills Committee

Oral evidence: Access to Finance, HC 866

Wednesday 4 May 2016

Ordered by the House of Commons to be published on 4 April 2016.

Watch the meeting

Members present: Mr Iain Wright (Chair); Paul Blomfield; Richard Fuller, Amanda Milling; Amanda Solloway, Michelle Thomson, Kelly Tolhurst and Craig Tracey

Questions 1 - 77

Witnesses: Suren Thiru, Head of Economics and Business Finance, British Chambers of Commerce, Jimmy McLoughlin, Head of Entrepreneurship Policy, Institute of Directors, and Tom McMurtrie, Managing Director, Hymid Two-Shot Ltd and EEF member, gave evidence.

Q1 Chair: Gentlemen, good morning. We are sorry to have kept you waiting. Welcome to the Committee. We are looking at access to finance and we are very grateful for your attendance. For the purpose of the record, could you tell us who you are and which organisations you represent?

Suren Thiru: I am Suren Thiru, Head of Economics and Business Finance, British Chambers of Commerce.

Jimmy McLoughlin: Good morning. I am Jimmy McLoughlin from the Institute of Directors.

Tom McMurtrie: I am Tom McMurtrie, Managing Director of Hymid Two-Shot, here as an SME manufacturer.

Q2 Chair: How has the landscape for access to finance changed since 2008?

Suren Thiru: The overall credit environment has improved over the last few years. We have seen multi-market improve, access to finance fall and more established businesses improve. Having said that, there are still major black spots out there, so some sectors are still struggling to get finance. I will go into more detail on that if required. Also, there are long-term structural issues that exist in banking. Some of those young, fast-growing companies are still struggling to get the finance they need. These are companies that do not necessarily have bad credit history, but have little credit history. They are struggling to get the finance they need to grow. In addition, there are issues around competition in banking as well. I know that the CMA is undertaking an inquiry into that. That still remains an issue as well.

Jimmy McLoughlin: I would echo a lot of those comments. There was an inevitability when the crisis happened that the banks became less risky when they were doing their lending. Therefore, they would look to the bigger companies when they had larger property that would underwrite that and make the loans feel safer. We are moving back towards the level we saw before the financial crisis. During 2010 one in every three IoD members was being rejected for a loan by big banks; that has reduced to one in six now, which shows a much healthier mix between the markets. The Committee might want to talk about this more later, but over the last five to six years you have seen development in terms of the type of credit that companies are able to access through different ways, such as crowd funding, peer-to-peer lending, etc. That has been a real positive development for the market as well.

Q3 Chair: In comparison with before we went into the financial crisis, are we now seeing a more diversified playing field?

Jimmy McLoughlin: Absolutely. There is much more diversity. The alternative finance sector still makes up a smaller part of it, but one of the things we do at the Institute of Directors is run a young entrepreneurs club called the IoD 99, which people join for £99. There were 500 members at the end of last year. We surveyed them and it was quite interesting. Over the previous five years the loans to banks that they classed as important or very important was 19%. They think that is going to rise to 40% over the next 10 years. It shows that banks are still important in that bridging area. The equity crowd funding section is also interesting. Over the last five years, 8% of them said that was important or very important; over the next 10 years, 38% said that was going to be important or very important. That was a market that did not really exist over five years ago. That shows how diverse the playing field has become.

Q4 Chair: Tom, do you think it is more diversified now than it was in 2008? Are we getting back to normality after the financial crash?

Tom McMurtrie: I believe we are. Whether we have gone far enough is another matter. Certainly, in 2008-09 there was an aversion from high street banks to supporting businesses, particularly SMEs. As a result, we had to switch banks as a company, which is why I feel quite passionate about it. In the last five to seven years it has improved and the high street banks have changed their approach. We have a much more constructive relationship with them, in part because we are a manufacturer; we have assets. Therefore, they can leverage those assets as part of loans, overdrafts, foreign exchange, etc. It is very much about relationships. It is better but still, if I am looking to invest and bring in new plant and machinery to try to bring in some reshoring work, there is a lot of paperwork you have to go through. They are still fairly risk-averse.

Q5 Chair: You mentioned at the start—this contrasts with Tom in many respects—that a lot of new companies in this knowledge-based economy will have few assets and little credit history. How on earth do they get access to finance? Have we cracked that nut yet? What do we need to do to help these young, fast-growing companies?

Suren Thiru: No, we have not. This issue is not necessarily a consequence of the financial crisis; it has been here for decades, since the Macmillan gap was first identified in the 1930s. It is about providing finance that has not necessarily been provided by the incumbent lenders in the market. Our view is certainly that the business banks should play a role in this area: filling gaps in the market that other providers will not. That could be, for example, riskier capital. We have been big supporters of the Business Bank; it is doing a lot of good work filling those gaps in the market. Currently, it is operating on too small a scale. There needs to be more funding in it to help it fill in that quite big funding gap.

Q6 Chair: You all mentioned banks. If we are looking at young, fast-growing companies, in order to get growth capital, are banks the right place to go? Should it not be more equity finance? Should it be those alternative financial products that are considered, rather than going to the bank and getting a loan?

Suren Thiru: I agree. That sort of funding is not necessarily something that the banks have ever provided. That is why we feel the British Business Bank should play a role here. The market is not necessarily providing that; in some ways, there is market failure going on there. We are saying that the Business Bank should step in and fill in those gaps. They are doing that to a certain extent, but the funding they have available it is still very small when compared to their international competitors.

Jimmy McLoughlin: Much younger founders—those under 35 or 40—have a very negative perception of the banks, and therefore will look at almost any other form of finance that they can use. The reliance of young companies starting on family and friends is massive for that initial seed funding. That is something that we desperately need to try to change. When you look at the survey, you only have about one in 10 people who have access to family finance but do not use it. You are ruling out a huge amount of people there that might have great ideas but do not have that family finance to back them. That is a great shame and something the Government need to look at.

Q7 Chair: Why do younger people not like banks? Is it just because they have been brought up in the financial crisis? Does this lend itself to the discouraged demand that the British Chambers of Commerce's evidence suggested? What is it about banks that younger entrepreneurs do not like?

Jimmy McLoughlin: It is as simple as that, in terms of the financial crisis. They have grown up with a lot of the banks saying no, and not even being able to get in the door to be able to pitch the idea. They are being declined out of hand. Therefore, they feel negatively about that, and the financial crisis has added to that as well.

Q8 Chair: Tom, is that your experience? You said you had to change banks. What were the circumstances leading up to that?

Tom McMurtrie: In essence, we lost a major customer. As a result, from being profitable we became loss-making and the bank withdrew its facilities. We had no choice; we had to change. The business continued through; in part, we did not take salaries and individuals put their own money behind the cause. We manufacture nothing that we sell ourselves so we are wholly reliant on the customer coming to us with the product or the idea, and we will turn that into reality. They will then sell it on. Following Jimmy's points about start-up businesses and young companies, if you approach a bank the first thing they will ask you for is a joint and several guarantee. You have to put something up in order to get that loan, and that is what scares people. If it is for the full amount, it is your house, your livelihood and your family. Family finance or other methods are a better way of doing it. As a shareholder rather than a director of a business, my attitude to risk as a director is different from my attitude to risk as a shareholder, because it is my money.

Q9 Amanda Milling: Can I explore a little more about the traditional banks? We have seen improvements in lending. Amongst some of the small SMEs there is an argument that bank lending is not necessarily improving. I take an example from Friday. I went to visit a local business and they spoke at length about issues with their bank and not being able to get any lending from it. They are a well-established business looking to grow and export. They were doing all the right things. Is this something that you recognise as an issue still amongst these smaller businesses that are looking to grow and export?

Suren Thiru: That is an issue. There is good finance out there for businesses starting up for the first time; start-up loans, for example, are really successful. They do a lot of good work within the market. Moving beyond that, there are issues, as you say, around finance for those looking to expand—moving through the business sizes is an example—looking to export for the first time, and export to new markets. When businesses are looking to make that sort of move there are issues around finance.

To come back to your point about the banks, we run a project called Business Banking Insight alongside the Federation of Small Businesses, which provides businesses with reviews of customer service quality across the banking sector and the financial service in general. We have seen that there has been a slight improvement in the satisfaction with banking over the last year or so. However, they are still at relatively low levels.

Jimmy McLoughlin: I would echo a lot of that.

Tom McMurtrie: Our customers have struggled, partly because they do not have the credit history. Our personal experience has been quite good with our high street bank. They have supported us with invoice financing, foreign exchange and energy surveys. They have become more of a one-stop shop in the last five or six years, which is a sign of the work that you guys have been putting in, which has definitely helped. Because we have a credit history and there are no surprises—bad or good news, we share it—they are prepared to give us loans. We are trying to bid for some reshoring work at the moment, which is great. It is UK plc securing work from eastern Europe. We are productive. That has taken investment but they are prepared to support us. It has been a positive experience. We may be a minority.

Q10 Amanda Milling: You also talked about switching banks. You have had bad experiences. I am wondering whether you are starting to see more evidence of small businesses going as far as switching banks in order to be able to borrow. In theory, switching banks is easier for small businesses now with the current account switching service. Are you seeing evidence of them switching and is it any easier for them?

Tom McMurtrie: Doing a straw poll amongst other SMEs in the south-west, which is where we are based, generally speaking it is not worth the effort because the differences are not appreciable. Disengaging yourself from a bank is hard, no matter what you say. In our case, there is invoice financing to think about, there is foreign exchange, there are the current accounts, there are the savings accounts, the overdrafts and the guarantees. There is a lot of paperwork and business support, which is not adding value in order to go through that change. It needs to be a pretty fundamental advantage to justify the change. The high street banks are all pretty similar, not the challenger banks.

Q11 Chair: I was going to ask about the challenger banks. Is there a distinction between the traditional banks, which still provide something like 80% of access to finance, and the challenger banks? Are they disrupting and providing a better service for businesses?

Suren Thiru: We have heard some instances of that. Handelsbanken is an example that often gets put forward to us. They have a different model in that a lot of the decision making is locally based. That often gets thrown as feedback from our members; that decision making on getting a loan, for example, can be made centrally based on the credit score black box. That is the perception, anyway, and that feeds through in things like discouraged demand, as you mentioned. They do not apply in the first place because they do not think they are going to get a loan.

Jimmy McLoughlin: It comes across from our members that they are providing more of what feels like a personalised service. When you go to the big high street banks it is that tick-box, "No", and very formulaic response. The challenger banks at least are seen to see people and go through the issues in that more traditional model that we have perhaps romanticised a little bit about from previous years gone by. It feels much more as though they are at least getting a hearing, even if the answer they get is not what they want to hear.

Q12 Chair: Tom, did you move from a traditional bank to another traditional bank, or did you move to a challenger?

Tom McMurtrie: In 2008-09 it was high street to high street. I have to say now that we have had a challenger bank recently. They are very constructive, very proactive and we are running them as a shadow bank. They are seeing all of our management accounts and we are sharing with them our aspirations, in many ways to benchmark them against the high street banks and see how they perform.

Q13 Amanda Milling: I am business X. I have gone to my traditional bank to get a loan and they have said no. You are saying it is too much hassle and it is not worth switching banks. What happens to that business in terms of getting a loan? Do they just stop, in your experience?

Tom McMurtrie: Our customers may go to a crowdfunding platform. If it is a particular product they wish to launch then they should have gone to the bank with a business plan anyway. If that business plan has not been accepted or there is not enough collateral to support it, then they may well choose to go to an alternative funding platform and seek money that way. Rather than support the business, it is about a project.

Q14 Amanda Milling: Do you think the majority of small businesses are aware of all the options available to them outside the traditional London banks?

Tom McMurtrie: Invariably, no. As a manufacturer, we end up providing financial advice to customers. We are doing design for manufacture, someone comes to us with a concept, they want to make that and we will tell them how to manufacture it. "Have you thought about marketing sales? Have you thought about finance? Who is going to source the funding? Who is going to cash-flow it for you?" We will try to point them in the direction. I will put a word in here for the Manufacturing Advisory Service, which was funded by BIS. It is an excellent service provided to SMEs, and there are thousands of us out there who do not make end-user products; we provide them to other companies to assemble. They provided a really good service, free at the point of delivery, that provided exactly that advice.

Q15 Amanda Milling: Do you find yourselves doing the same thing in terms of providing guidance in relation to other options to your members?

Jimmy McLoughlin: Yes, we do. The awareness of different things can often be quite low and that comes from different kinds of funding options. Also, when you look at various Government schemes that are there to help as well, sometimes we forget that while we are all very interested in these schemes, somebody who is employing three people and working 16 hours a day to get on and run that business does not necessarily want to log on to the BIS website and try to navigate those corridors to try to find out where those things are. I am sure that sounds thrilling to all of us but it does not so much to them. That is just the nature of things. It is easier to find out information now than it was 10 or 15 years ago. It is still quite difficult if you do not know where you are looking.

Suren Thiru: The point on information is a good one. The amount of information available to SMEs has improved, particularly with respect to new types of finance. There is still reluctance from SMEs to take that step forward. They are keener to stay on traditional forms of finance. Some of that surrounds understanding which type of finance is most appropriate for them, and also where they should go if something goes wrong. That is an issue as well.

Q16 Amanda Solloway: It is fascinating. Putting challenger banks and alternative finance aside and going back to high street banks, you were talking about people having to maybe put their house on the line. Is there anything that you think banks should be taking into account that would mean they did not have to put their house on the line? In other words, if the idea was good, is there anything that banks could be doing so that they would give out some loans?

Tom McMurtrie: One that has worked well is the EFG—the enterprise finance guarantee. We have actively used that. That has worked where you have had not a risky venture but a venture that has risk with it. Having the enterprise finance guarantee made it more palatable to the bank to give us the loan. Whether they should have needed to have had that is another question. That was positive. Also, we funded some new equipment for the system through a GAIN Growth Fund. We used European funding. Having gone through the paperwork trail, we got support from the banks. Getting the banks involved early in that process—even before we had got there—was useful. The banks need to get out from behind the desks, come and visit and understand the business plans rather than you thinking that you have to go cap in hand to request funding.

Q17 Amanda Solloway: What they are trying to do is avoid failure in terms of loss of money, I guess.

Tom McMurtrie: Yes. It is defensive.

Q18 Richard Fuller: Obviously there is a funding gap for a company that does not have money to fund itself. We have talked a lot, system-wide across the UK, about there being a funding gap for investments of a range. Where is the problem in that funding gap system? Is it £5 million to £10 million, or £500,000 to £1 million? Where is the biggest range of gap in companies looking at access to finance?

Suren Thiru: We do not have any evidence in terms of where the range sits.

Q19 Richard Fuller: Is there one?

Suren Thiru: We are not aware of one.

Q20 Richard Fuller: There is no funding gap.

Suren Thiru: We see it in terms of certain sectors. In construction and hospitality, we see those sectors, in general terms, trying to get finance. Those firms that are looking to make the next step up are struggling, whether they are at the small end or moving from a small business to a mid-size business.

Q21 Richard Fuller: There is just not enough money, for example, in construction. The issue is not that there is a funding gap from £5 million to £10 million of money going into construction versus £500 million; the issue is that there is not enough money going into construction.

Suren Thiru: Yes. There is also an issue around risk. The managing of that risk is a key issue for banks in particular. For example, when an exporter is going into a new market, there is a risk associated with that. Overcoming that is the issue for many businesses.

Q22 Richard Fuller: You are saying that the main issues of the funding gap in the UK are that banks or finance providers are not able, in certain sectors, to correctly assess the risk, reward and return on investments in, for example, construction or on a new type of endeavour—an export market being one—where they just do not have the skillset to do it. Is that what you are saying?

Suren Thiru: We would not necessarily be aware of that. It is the perception of businesses that when they go to get that type of finance and to make that change, they are still struggling to get that finance.

Q23 Richard Fuller: Thank you. That is very interesting. Mr McLoughlin, is there a funding gap on numbers?

Jimmy McLoughlin: We do not have any evidence to back it up, but to use anecdotal evidence—

Richard Fuller: You are in Parliament; that is what we do all the time.

Jimmy McLoughlin: You can argue that anecdotal evidence is an oxymoron. One of the areas in which we do struggle in the UK is the Series B aspect when it comes to venture capital. In that £10 million-plus area we struggle to get VCs that are big enough to inject that capital. To give you an example, there were two chaps who created the cleaning app Mopp, which is where you could book your cleaner through an app. They woke up after a house party and thought, "I want to get this cleaned." They found it very difficult and so created a marketplace app online where they could do that. They ran it for 18 months and got venture capital funding, Series A round. They grew it. The problem was that the American equivalent came over and said, "I will buy you." They would have loved to have taken it on and possibly had a crack at America eventually, but they were too far behind by that point. There were two apps out there both at a similar time in the UK, Mopp and Hassle. They were not able to compete. It shows how quickly the world is moving. It is very difficult to work out how the UK can do that because American companies are always going to grow faster.

Q24 Richard Fuller: Series B is £10 million to £25 million raised.
Jimmy McLoughlin: Yes. That is the issue at the minute.

Tom McMurtrie: I cannot comment on the larger business; we have a £2 million turnover. That is my speciality, as it were. Companies have varied credit histories because not all companies run well all the time. They tend to be cyclical. Those companies that have had a bad period will invariably find it more difficult to find funding.

Q25 Richard Fuller: So you are saying credit history is a big determining factor on whether—
Tom McMurtrie: From what we see, it would appear to be a big factor.

Q26 Richard Fuller: The Government have done a number of schemes, some of which you have mentioned. I am going to draw, Mr McLoughlin, on some of the evidence you provided on additional ways the Government could look at funding relatively small businesses at the earlier stage. The principle is that the Government can take money from taxpayers and they can say, "We will put some money in that. It is very important. There is a gap. Let us go and try innovation in this area. We will set up a body and they can go splurge cash out at companies." Or the Government can incentivise taxpayers through BIS schemes or through the new innovative ISA. Which direction of travel would you say would be more productive in the long term, better at solving the problem? I know it is maybe an either/or, but give us some sense because obviously the Government do not really have any money. Which of those two approaches do you think would have the best impact?
Suren Thiru: Something like the income tax solution, as you mentioned, and the Enterprise Investment Scheme are very popular. They have the effect of funding finance to businesses, where it would not necessarily be available without those schemes in place.

Q27 Richard Fuller: Your assessment is that they have been very successful.
Suren Thiru: Yes, they have been very successful.

Q28 Richard Fuller: And similarly for the SEIS?
Suren Thiru: Yes, and the venture capital trusts as well.

Q29 Richard Fuller: Would you say there is clear evidence of success where the Government create tax-efficient structures for the taxpayer to make the decision about where they want to put their money in to support smaller businesses, rather than the Government putting money in?

Suren Thiru: Anecdotally, we have heard good feedback on those schemes from members. As I said, it is finance that would not necessarily be available if the schemes were not there. That is important. Also, some of the Business Bank schemes have been very popular as well—we talked about start-up loans earlier. Schemes from the Business Bank have proved quite successful. Having said that, there is a broader point about some Government schemes that have been put down over the last three years: there have been so many. That is an issue we hear from our members. They have not been around for that long—that is another issue. The delivery of those schemes has also been an issue—delivering through banks, for example. There is an expectations gap in their delivery. A consequence of that has been that greater expectation from businesses at the moment.

Richard Fuller: In your evidence you had lots of good ideas.

Jimmy McLoughlin: I agree with a lot of that. One of the things to flag up about SEIS and EIS in particular is that awareness of them is incredibly low. Only two in every three of our members has heard of EIS, which has been around for two years. Only one in three has heard of SEIS. When you bear in mind that we have 35,000 highly qualified directors, these are the people that really should know about them. Also, according to the last statistics, the amount of people who are using EIS to invest is only about 26,000 in the United Kingdom. When you bear in mind that in the same year that those statistics come from we had 3 million people open a stocks and shares ISA in the UK, there is clearly a huge amount of demand there to invest in things. We want people to be taking active investments in where they are going and to really look at things. I am sure we have all done stocks and shares ISAs. It can often just be a case of ticking 10 questions and then never thinking about it again. If we can get people thinking much more about where they want to go—

Q30 Richard Fuller: Are you essentially saying that if the Government simplified the process for some of these schemes, that would make money flow more easily because EIS schemes are notoriously complicated to fill in?

Jimmy McLoughlin: Yes. They are. You could look at whether you can deduct it from someone's PAYE or somewhere that you could go like that; it would be quite a radical move but it would make it much more—

Q31 Richard Fuller: You talked about £2,000 per annum online system for claiming tax relief on investments. That sounds like a very simple way.

Jimmy McLoughlin: There are a lot of people out there who do want to invest in companies but who would say, "Oh, I don't want to do that because I might lose all my money." That is not true: you might lose half your money, which is still not great but it is not the same amount. It has cut it by half. If you do not know about that, that is a real shame. What the Government could look to do with the British Business Bank is potentially to build an aggregator where you get to invest in, say, 10 firms at a time, because it is daunting. Even with the rise of crowdfunding and so on, it is quite daunting to hand over your money to a business if you have not done it before or if you do not know the difference between types of shareholder structures. It is quite complicated. People are excited by these things. I am not saying the Government should put money into this, but if you had an aggregator that was going to invest in 10 companies at £200 each and, let us say, it is up to £2,000 then at the end of the three years, so long as you have kept your money in, you would get £650 or £700 back. Okay, you might lose the rest, but you will have probably taken a lot of interest in those 10 companies. That would be great for us in terms of the cultural ambition. If we were putting those into firms such as Mopp, Hassle and so on, people would be prouder of British companies.

Q32 **Chair:** Richard has unearthed a range of really interesting themes. Before I bring Craig in, I will just ask several quick questions. You mentioned the unfashionable nature of several sectors; construction was mentioned. What about regions? Is it that the further you go out of London, the more difficult it is to get funding? If you are based in the north-east or the south-west, it is very difficult. What are people's views about the geographical aspect of access to finance?

Jimmy McLoughlin: That is true. If you look at the SEIS and EIS statistics as an example of that, that is where people are investing. It is not necessarily where the companies are; it is where the investors are. Again, you can point to a certain geographical reach, so 65% of those transactions are happening in London and the south-east. That is a huge amount and it shows that it is more difficult in the regions.

Q33 **Chair:** Tom, did you feel at a disadvantage because you were based in the south-west, not London?

Tom McMurtrie: In terms of finance, no. The one thing I would say, which I did not get a chance to earlier, is that R and D tax credits are definitely worth a plug. As an SME we have made use of them for only the second time this year. It is direct from HMRC so you are not involved with any intermediaries. We had our HMRC inspection two weeks ago. They come around once every 10 years and it has made them no longer a faceless bureaucracy but someone with whom we can engage as a partner. Because that money is coming direct to you, it is encouraging and motivating you as a shareholder and director to invest in research and development entrepreneurial work. That has made a difference. As an SME particularly, I have European competitors who are jealous of the scheme, which is always a good thing.

Q34 **Chair:** Jimmy, you mentioned before an undeveloped venture capital system, certainly compared with the United States. Maybe this is not a role for Government, but how do we solve that problem? What do we do to develop more thoroughly that ecosystem of VCs?

Jimmy McLoughlin: It is one of these things where we need to work on the culture and that is very difficult for Government to do. It is to try to get Britain to be more ambitious when it comes to these things. What I would say is that 10 to 15 years ago we did not have much of a VC industry at all in the UK. The fact that we have a small one with Series A shows that we have come a long way. The problem that we do not have any Series B, as so often, is the fault of our own success at the moment.

Q35 Chair: Is all of this not just a reflection of the relative risk aversion of our country? People are reluctant to invest in potentially risky ventures. That is why EIS has not taken off as much; small companies are not going to banks because they think they might not get a loan. There is that general culture of risk aversion. Is that where we are?

Jimmy McLoughlin: There is a bit of that but I do not see any reason why that cannot change. We can stereotype ourselves sometimes as a nation that is like that, but when you look at the statistics that show that the internet economy is going to make 12.5% of UK GDP this year, that is a remarkable statistic on its own but even more remarkable is the fact that the next country in the world is South Korea on 8%. We are over 50% ahead of our nearest competitor when it comes to the internet economy making up a part of GDP. Those are Boston Consultant Group statistics. It is remarkable.

It permeates our society but when it comes to the investing side of things, as we saw yesterday with the L&G stats, we are a society that is very keen on investing in bricks and mortar and in property all the time. When you look at SEIS or EIS, one of the most crucial things about them is that family members cannot claim the relief. If you want to invest in your son or daughter's business then you cannot claim tax relief for that. We have heard of a few examples where parents have said, "I will give you £20,000 instead towards a house deposit, as opposed to starting a business." That is a real shame. I understand completely why the parents do that, but we need to encourage that side of things.

Q36 Chair: That is very interesting. There has been a lot of talk in this House recently about inheritance tax planning. Is this all linked in as well, in terms of how we ensure the next generation funds the next generation of businesses?

Jimmy McLoughlin: I had not thought about it in that context, but I am sure it is.

Tom McMurtrie: I look around the table here, and a lot of our customers are younger than me. That is a generation coming through who have a difference approach to the attitude I have had. They have been less burnt by the recession. They are a lot more entrepreneurial but they are struggling with an existing eco-structure that is servicing the old models. We are a consumer-led society. That is a fact of life. I wish we were a nation of makers; we are not. That is where you need to go. Businesses and B2B deliver that, rather than B2C. That requires investment.

Suren Thiru: I would agree that there is a certain amount of risk aversion out there. That is clear. That is with good reason. It has built up over the last few years. We talked about discouraged demands. There are things out there. We hear from our membership that businesses often rely on their own peer group for views on what is happening and what the relationship is with all types of suppliers, including banks. If one business has had a bad experience, that often can lead to other businesses not going for finance in the first place. It is more around those actual issues out there, rather than inherent risk aversion.

Q37 Craig Tracey: You touched on signposting to finance, and certainly that is something I recognise from businesses in my constituency, particularly manufacturing, R and D or the new technologies. Also, even when they are signposted to particular places like growth hubs, one of the big complaints seems to be around consistency of advice. Is that something that your members or other businesses have come across? How do we ensure that the advice given in London is consistent with the advice given in Bedworth, for example, which is in my constituency? Is that a geographical issue?

Tom McMurtrie: In the south-west, when we applied for Government funding the paperwork trial was painful. We withdrew from the process after three months because it was too painful. It was taking up too much time. We came back at it two months later, when we had asked to have it simplified and we achieved the aim, securing some growth fund, which was great. In our case I would say, first, use of networks within SMEs; I am a strong advocate of use of networks. The Manufacturing Advisory Service was an excellent network. Secondly, there is the use of case studies. It is only when I have a peer telling me it has worked that I am likely to try it.

Q38 Craig Tracey: In terms of the networks, do you feel that Government should not be providing that? Should that be more business-led or LEP-led?

Tom McMurtrie: The credibility of the network tends to be business-led. The more business-led it is, the more people will attend and listen.

Jimmy McLoughlin: I would echo all of those points. When we have surveyed our members where they have heard about different schemes and when they have tried them, it is from peer-to-peer networks. Very few hear it directly from Government and think, "That is a great idea. I must do that." It is somebody else saying, "This is worth the time. This brings real benefits."

Suren Thiru: I would also echo that, and that is why we work alongside the Federation of Small Businesses on the Business Banking Insight project, which does that very thing. It is essentially a website of 20,000 businesses reviewing the performance of their finance provider across a range of products and services. Businesses can go on there and see how their peer group rates a particular bank in providing a particular type of service.

Q39 Craig Tracey: Have you any experience of the growth hubs? Do they provide practical advice? Would you still push your members toward networks and your own services?

Jimmy McLoughlin: The best examples that I see from a regional point of view with the Institute of Directors is where growth hubs and local enterprise partnerships are all based near each other. There is a great example down in Bristol and the south-west, with the Engine Shed there. We have not discussed this before. That is where the local enterprise is based in the co-working hub with the Institute of Directors. That works tremendously well. Likewise, in the east midlands the Institute of Directors is based in Nottingham Trent University, which means that we have a great student branch there, which means that people are far more interested. It is about trying to drive those co-working areas and get as many people as possible. It is where ideas are shared.

Suren Thiru: I would also say that chambers across the UK could also play a role in signposting businesses not only to types of finance, but to business support as well.

Q40 Craig Tracey: You talked about youth having a different attitude to finance, which I get. One of the big untapped markets that we seem to have is around female entrepreneurs. I know the IoD has its first female Chair at the moment. The evidence is that women, in particular, find access to finance the biggest barrier to them starting in entrepreneurship. They also use a narrower range of finance than more down the traditional banking sector. Would you say that is the experience of your members? What role do you think your bodies can do to assist that and help to grow that market? Is there a role that Government can play?

Suren Thiru: It is not something that we have tested. We are happy to go away and get a sense of that. A lot of it is around providing information and that goes for other parts of the economy that are struggling to get finance as well.

Jimmy McLoughlin: Networks are a big development of it and it extends from what we were just talking about in terms of sharing those ideas and sharing that knowledge. It is an area that is under-researched. In terms of women entrepreneurs, we do not have much data around that. I know you chair the all-party parliamentary group on women and business. We stretch too much at times into turning anecdotal information on it. There is research out there in relation to crowdfunding, particularly in America, that women are more successful going via that route that any others. The reasons behind that are not quite clear yet.

Q41 Craig Tracey: Is that US businesswomen?

Jimmy McLoughlin: Yes. I have read the data somewhere. I cannot remember the ins and outs of it. I will find it and send it to you. Often women are more successful on crowdfunding platforms. It is a big issue in America in terms of venture capital as well. Not many women get venture capital funding.

Craig Tracey: That is the same in the UK. There are very few women who use private equity or venture capital.

Tom McMurtrie: I am not a great help, to be honest. I am not here representing EEF as such, but certainly anecdotally I would say probably 25% of our customers or the decision-makers within customers are females in our business. They have equal pay, I suspect, as anyone else who tries to secure the funding.

Q42 Michelle Thomson: Thank you for joining us this morning. It is very interesting. I am interested in probing more in terms of your memberships and the relative attitudes to risk between challenger banks and traditional banks. We know what happened post-crisis and you mentioned construction specifically. We have this curious anomaly where we have a chronic under-supply of affordable housing and yet the traditional banks are still, based on what happened previously, going, “Oh, we don’t want to touch that.” Do you see, in that sector and others where traditional banks withdrew, the challenger banks picking up the slack, or is it completely extensive? Where previously they went, “No, we are not doing it anymore,” are challenger banks picking up the slack, or is it an issue in certain sectors regardless of who has the money?

Suren Thiru: We do not necessarily have evidence on whether challenger banks are picking up the slack. We hear that there is still an issue.

Michelle Thomson: The chances are they might not be.

Suren Thiru: Or at least not fully filling in the gap.

Jimmy McLoughlin: If you look at crowdfunding in place of the challenger banks, it is not necessarily replacing the funding that high street banks used to do. One example that is quite interesting, from Kickstarter, is a gentleman who described himself as part-visionary, part-mad scientist and full-time DIY specialist, who wanted to create this new cool-box. He would never have got in to see a typical high street bank with that description and wanting to do that type of thing. The thing that he has developed is brilliant. He has lights in it; it is the perfect cool-box that you need. He has been able to get almost $10 million funding by going on a crowdfunding website as opposed to going to a high street bank. Crowdfunding and challenger banks will not necessarily replace the traditional high street model; it is opening up entirely new avenues.

Q43 Michelle Thomson: You have led me neatly on to what was going to be my second question, about challenger banks or other types of capital. I accept that it is an anecdotal view, but is it true that the challenger banks and other types of funding are more amenable to innovative and therefore inherently riskier products than the traditional banks? Is that where the natural split is occurring? It is something that is untried and your comments about credit history apply in that. Do you see that that is where the split is happening?

Suren Thiru: One example is that is more from the customer service angle: for example, the challenger banks operate longer opening hours, which helps businesses that are up all day working and need to do the banking in the evening. In those areas, we are hearing that there has been quite a bit of innovation with the challenger banks compared to the incumbent banks.

Tom McMurtrie: I can talk about manufacturing. Challenger banks have come in very aggressively, which has been good to see. I suspect that is because we are seen as a safer risk because of the assets and, in our case, we have a trading history. If you do not have assets and you do not have a trading history, it may be a different conversation. Where the challenger banks are opening up the competition for us, that is good. Whether it is helping the service industry and wider industries, I am not so certain.

Jimmy McLoughlin: One thing that is interesting from our IoD 99 network is that when we surveyed them, two thirds started their business when they were in full-time employment. In that sense, people are starting businesses on the side. They may need a bit of finance to help with that but they certainly do not want to be taking loans against property or anything like that. They are almost taking it up as a hobby to see how it goes and then it goes quite well. Starting a business is not the risk that it once was in the sense that you stop work on the Friday and then you start the business on the Monday. There is much more of a grey area where people are doing both. That is where some of the alternative finance is filling in that whole new area.

Q44 Chair: Tom, I am looking on your website. It is really impressive. You provide the plastic casing for the Raspberry Pi. It is a fantastic product. I was going to ask about your customers. You sell into healthcare and into pharma. Do you sell into the automotive industry?

Tom McMurtrie: No. Strangely for us, our customer cross-section sits in healthcare, instrumentation and consumer electronics. We do not provide finished goods; we provide components that they then use to assemble. We target UK manufacturers so that we provide that just-in-time service, so they are not waiting for a container from China that pops in at Lowestoft and has rubbish in it. We can be on their lines within eight hours, and we can inspect the parts and really work them. That added value service piece is why we are securing quite a lot of reshoring work. We avoid the automotive, defence, aviation and aerospace sectors because there is so much paperwork and pain, and you need to have a critical mass to be able to compete in those markets. As one of the thousands of SMEs out there, we are a tier 3 and tier 4 supplier who sit off the bottom. We target where our niche capabilities work. It is fundamentally about productivity. You have got to be a productive business with a niche capability to succeed.

Q45 Chair: That is really interesting. The reason I asked is because I was wondering whether supply chain finance in key sectors is working. What are your experiences of that as a tier 3 and tier 4 supplier?

Tom McMurtrie: When you are working with a supply chain made up generally of fellow SMEs—and the majority of us are—they operate under severe constraints. Encouraging them to provide novel and new components, assemblies or processes to help you do what you need to do is a challenge.

Q46 Chair: Do you sell directly into the NHS, or is it always through pharma companies?

Tom McMurtrie: Through healthcare rather than pharma, I would call it.

Q47 Chair: We have got long-term systematic market failure. The 1931 Macmillan Commission criticised the flow of finance into productive parts of the economy, so this has been around for a long time. Government have a role. What would your advice to the Committee be? What are the couple of things that Government need to do in order to try to decisively address that long-term systematic failure about access to finance?

Suren Thiru: There are two things. The first is around competition in banking, which I touched on earlier. That means looking at market barriers to entry for new participants. For example, one thing we have been looking at is the role that building societies could play in SME banking. Currently they are constrained by capital requirements and by the way they are set up. We should look at those sorts of areas—not only building societies but other potential new entrants as well. The second thing is freedom of information. We are doing some work on Business Banking Insight to make sure those products are available to businesses more widely and that there is greater awareness. Also, again, there are structural issues around the provision of long-term patient capital. That is key to the long-term improvement in fixing some of these structural issues first identified by the Macmillan gap.

Q48 Chair: You mentioned building societies. Is there an appetite amongst building societies to get into business lending rather than that tried and tested traditional model that they have tended to focus on, which is mortgage borrowing?

Suren Thiru: We have spoken to a number of them and there has been a keenness to get involved. It does come back to those capital requirements that are involved and are proving to be somewhat of a barrier.

Jimmy McLoughlin: I would echo a lot of that. One of the best roles Government can do is to signpost it. Government have done that well in recent years, in terms of when they talk about thing like Tech City, and saying, "We are open and we want to be the FinTech capital of the world." They have not actually put a huge amount of money into that, but Government just using their ability to go abroad on trade trips and advocating that stuff is really encouraging. The Government need to try to do more of that. When it comes to the provision of information, often our members will say they have not heard of various Government schemes. They will regularly say, "We do not hear from BIS," but they certainly do not say, "We do not hear from HMRC." When HMRC communicates with members and businesses of all sizes, it could include a single A4 sheet outlining the various schemes that are available to them. It is a simple change that could make quite a big difference.

Q49 Chair: Tom, given your experience, what would you like to see changed?

Tom McMurtrie: All I would ask for is certainty. The rate of change is disruptive to businesses trying to plan. We have enough challenges with the economy already, so give us that certainly that allows us to do what we do well. Secondly, where you have schemes like R and D tax credits or funding, set the KPIs correctly. The funding we secured was about adding more permanent employees to the company. That is not making us more productive; it is just meeting a number that is a bit meaningless. I would much prefer to have a gross value add or productivity target to hit, and then we can do the job.

Chair: Gentlemen, thank you very much for your time. I think I speak on behalf of the whole Committee when I say this has been incredibly useful and helpful. We are grateful for your insights. Thank you again for attending.

Examination of Witnesses

Witnesses: **Andrew Sandiford**, Partner, Bishop Fleming, and **Simon Littlewood**, Partner, Grant Thornton, gave evidence.

Q50 Chair: Gentlemen, we will make a start. We are slightly early, which is unusual for my chairmanship. Welcome to the Business, Innovation and Skills Select Committee. We are grateful for your time. For the purposes of the record, could you tell us who are you and which firms you work for?

Andrew Sandiford: I am Andrew Sandiford. I am a partner in a firm of accountants, Bishop Fleming. We have seven offices, down through the south-west and up into the west midlands. I am here today representing the Institute of Chartered Accountants in England and Wales.

Simon Littlewood: I am Simon Littlewood. I am a partner at Grant Thornton.

Q51 Chair: I started the first panel by asking how the landscape of access to finance has changed since 2008. What are your experiences of that? How has it changed?

Andrew Sandiford: It has certainly changed. It is a very different world now. The providers have changed. The banks are different. There is no doubt about that. The banks are doing different things now. There are a lot of new entrants in the market. It is a very complex market now.

The other thing, as was touched on in the earlier session, is that we are dealing with a scarred generation. There are some people out there who were very badly hurt during the financial crisis. There was some bad stuff going on in 2007, 2008 and 2009. A lot of people and businesses have a very jaundiced view of the banking sector, perhaps not always rightly so, but they have that view and those scars run very deep.

Simon Littlewood: It was covered a little before, but the variety of different places where you can find money now is unrecognisable from where it was. In 2007 it was easy to get money, because you could just go to the bank and get it. That dried up on the back of the crisis, and there was a proliferation of various different providers with creative ways of doing it. Mini-bonds emerged, which did not exist, at least not in the way they do now, and peer-to-peer platforms—that sort of approach. Even the banks themselves were looking at shifting rotational credit into things like asset-based lending and aggregation and that sort of thing.

Q52 Chair: Is access to finance still a problem?

Andrew Sandiford: It is very difficult. It is difficult for businesses to get finance. Because of that proliferation and variety, there is a need for a lot of advice. Historically, a business would have gone to the bank, asked for an overdraft and probably got it. That is unlikely to happen now. That funding is out there, but it takes a lot of finding; it takes a lot of digging around to get to the right sources and right places. Yes, it is a problem. It might not be the problem everybody thinks it is—that the banks are not lending. Bank bashing is a popular pastime and we all do it—I do it a bit. We all enjoy it a little, but the banks are doing something different now. The funders are different. Yes, it is a problem.

Q53 Chair: Simon, has your experience been the same?

Simon Littlewood: I come from a school of thought whereby there is not a problem with the availability of finance. The challenge is for people to understand what lenders are looking for and where to find it and what the different options are. To put that in context, we delivered what was GrowthAccelerator and the national Manufacturing Advisory Service over the last few years. 28,000 small businesses came through that process. Of those selected through the access-to-finance stream of activity, 87% of those who took some advice around what they were looking for around the finance were successful in terms of receiving funding afterwards. That represents an uplift of over 30% on the market average.

Andrew Sandiford: It is true those who seek advice are more successful. There is a longstanding statistic that less than 10% of businesses seek advice before applying for an overdraft.

Q54 Chair: I am going to come on to that, because that is very interesting. In your opening remarks, Andrew, you said the whole landscape is very complex and, Simon, you said there is a variety of different places where you can access money these days. If I have a small business with a great idea that I want to grow, what on earth do I do? There is this myriad different things. The Government have an initiative by the hour. I do not know where to go. What happens, and how do we make sure we simplify and clarify this for the benefit of high-growth small businesses?

Andrew Sandiford: I did a little exercise yesterday morning: "Okay, I have been told I need advice; where do I go?" "Growth hubs," is the answer. I googled "growth hubs". For a start, you have 39 different LEPs providing growth hubs, so I looked at four of the seven that relate to our geography—the south-west and the west midlands. Those four were all completely different. Two of them said, "This is only a provisional site". One of them did not mention growth hubs at all, and the other was so complex in its description of what it was, I had given up before I had got beyond the home page. There is regional variation, and we have to have something that provides for that regional variation. We also need some consistency, however, and growth hubs are not doing that at the moment.

There is a need for professional advice. We see it time and time again with clients coming to us. I will give you an example. A furniture business down in the south-west came to us having been turned down for an overdraft. He wanted £400,000. He had gone to his bank and asked for an overdraft, which is what he always does. "No" was the reply. He came back to us as a scarred businessman, but with some advice we pointed him in the right direction to a specific asset-based lender—one of the challenger banks—that can provide funding for that stock. However, he had gone to the wrong place. We could have saved him a lot of pain, time and anxiety had he sought advice in the first place and got the signposting to go in the right direction.

Simon Littlewood: It is worth listening to the market for where the answers come from. I see this consistently, echoing Andrew's statements, in surveys—and Government small business surveys, in fact—in terms of where people go for advice that they trust. A lot of the challenge with access to finance is around confidence and decision making. If I feel like my house is on the line, I need to be really confident that is the right sort of finance for me, for instance. People tend to go to professionally accredited people for advice that they feel they can trust. We are an accountancy firm, but this is not just about Grant Thornton. I am slightly nervous of the number of Government-backed bodies that launch with a new website every few months. I am not sure they necessarily have the longevity to be able to create a position as a trusted source of advice. They pop up, and if you are lucky you see them.

Q55 Paul Blomfield: I am interested in exploring the reasons for bank rejection of applications. When I talk to SMEs, primarily engineering ones that have been around for a while in my constituency, their assessment is that it is because banks used to trust their local guys to make decisions. They still have a positive interaction at that level, but when decisions process up the food chain there is a one-size-fits-all evaluation of risk, which is when the refusal comes in. Is that them looking back rosily to a relationship they had in the past that perhaps they did not, or is that the way you would see things going wrong with traditional banks?

Andrew Sandiford: There was some conversation earlier about where the gap is: the size of business or the size of loan where there is potentially a problem. Certainly, from our experience, there is a point below which everything gets passed up the chain in a very formulaic manner. It is a form-filling exercise. If you do not tick all the boxes, the rejection comes back down from on high: "You have been declined." That human interaction is missing. It is probably those looking for sub-£500,000. Sub-£500,000, you do not really get the bank's attention, and therefore it is an automated, bureaucratic form-filling process, and I think that is a problem.

I can understand why. There has to be some efficiency of delivery. One has to acknowledge the inherent conflict between de-risking the banks and asking them to make more risky loans. There is a conflict there.

Simon Littlewood: One element in that is people reminiscing about a time when things were easier. Now that things have changed—some of the lending criteria have changed and the risk profile has changed—it is easy to reflect back, as you identified, on a time when things were easier and think things are bad. Through delivering the Manufacturing Advisory Service, we ran some finance expert seminars for small and medium-sized manufacturers. There were 900 of them around the country in various different places. It was absolutely apparent how little dialogue they had with their banking and lending providers generally, although obviously there will be exceptions in there. However, that comes back to confidence in decision making, where there is a sense of nervousness of that interaction with the banking community—whether from the media or direct experience of someone calling in a loan at short notice or whatever it is. I am not sure all the evidence is there to support it, but it exists in the minds of people running businesses: "Do I want to have a conversation with the bank about some more lending there? Is that going to open up another much broader conversation about all the facilities I have with them," and all those sorts of things. Quite a large amount of that is myth. It is about confidence in decision making. What are the benchmarks? What could they reasonably expect? That is just about knowledge.

Q56 Paul Blomfield: I can certainly see that, but within the banks themselves there is a shift of approach post-crash. Is the driver for risk cultural and their own experience, or is it a sense of a tougher regulatory framework?

Andrew Sandiford: That is a question for the banks. We see the high street banks taking less risk—there is no doubt about that. Whether they were taking too much risk in the past is an interesting debate, but it is certainly a different approach in terms of the high street banks, and you need to prepare your case well and have a very clear evidence-backed proposition to take to the bank, otherwise you will not get anywhere. That human intervention is reduced.

Simon Littlewood: They are commercial organisations that have responded in terms of their risk profile. There is a sense that what has not proliferated is the communication of what they are looking for in terms of lending, as opposed to just saying, "Not you, not you, not you." That dynamic has had a broader impact on the market.

Q57 Chair: If you are that 22-year-old with a great idea in his or her bedroom but no credit history or assets, would bank financing be right for you? Where would you access that money in order to take forward your idea?

Simon Littlewood: A wonderful part of the market is around angel finance and that early-stage part of the market. How do we support that earlier stage? EIS, SEIS and such funds are bringing more capital into that space and encouraging more people to invest in higher-risk investments there. That is the starting point. You asked about things we could be doing, and one is raising the awareness of potential investors in that space of the EIS schemes and those sorts of things. They do well. If you look at repeat investors through those schemes, there is a good story there. I am just not sure how broadly it is told.

Q58 Amanda Milling: I have a couple of things I want to pick up on. You talked about the likelihood of being lent to by the banks. Does it vary between the traditional and challenger banks? Are you seeing any variation in their likelihood to lend?

Andrew Sandiford: There is an important distinction between what people are approaching the traditional banks to get and what they are getting from the challenger banks. A lot of the challenger bank lending is around asset-based finance. The challenger banks are not doing a great deal of mainstream banking. You do not go to Secure Trust Bank or whatever it might be to ask for an overdraft; you go to finance some specific assets. Again, un-statistically and anecdotally, I would say people are probably more successful going to the challenger banks, but that is probably because they are going with a very specific ask for a very specific purpose, rather than—going back to my example—asking for a £400,000 overdraft because that is what they have always done.

Q59 Amanda Milling: That goes back to the question I asked in the last session. On Friday I met a business that went to their bank and was rejected for a loan and ended up switching their bank. Is that something you recognise?

Simon Littlewood: That is part of the business model of the challenger banks. A large amount of SME lending is structured as a loss-leader for some of the banks anyway. They are looking for the broader bank relationship in terms of facilities around exchange rates and other services they can sell around all of that. For some of the lending schemes of some of the challenger banks—and even some of the more established retail banks—the expectations of switching other services to those banks is the motivation for that lending. The effect might be that somebody gets access to capital that is appropriate for them. They might not care who does their other banking services. It is important to recognise that is a factor in how they are addressing their need in their own business models of building market share. That is why they are there.

Q60 Amanda Milling: Are they being selective? When they are looking at that, are they looking at that business and all of its growth plans and export plans? Are the challenger banks and the less traditional banks looking more innovatively or more widely in terms of the opportunity?

Simon Littlewood: I do not have the evidence base to answer that, but I would say they are more creative. Certainly, if you look at what measure tends to get done and the measures they use to demonstrate their positioning in the market, it is around client acquisition rather than volumes lent.

Q61 Amanda Milling: The bank says "no", and you have talked about clients coming to you for signposting. What role are the banks currently playing in signposting to alternative finance options?

Andrew Sandiford: Currently, not a great deal. We have the new regulations coming in later in the year that will require them to signpost. We will have to wait and see how well that works. A mechanistic signposting to an asset-based lender just because that is what the computer churns out is perhaps not going to achieve a great deal. There is some self-interest in there obviously, but coming back to that advice piece is important. I do not know whether the banks are able to provide that advice, but there is a need for assistance to navigate this very complex market we now have, rather than a list of alternative providers.

Simon Littlewood: It is not contradictory but may just be the scale of client base. Certainly, we have very good relationships with a number of the banks, and we will do things like seminars where we introduce other types of crowdfunding platforms and that sort of thing. The point was raised earlier that they are not necessarily competing. Some of these are different sorts of money for different sorts of things, and that is okay. Part of it is them sharing what they are interested in, so that the quality of referrals they get as the bank is more appropriate for the sorts of money they are looking to get to market. They are not pretending that they are everything to everyone. Our experience is that they are quite happy to even try to educate some of their existing clients and prospects around the various different forms of finance available.

Q62 Amanda Milling: In order to fulfil their obligation as a result of the Act and be successful, what do you think the banks need to do?

Andrew Sandiford: As Simon says, it is about having a proper conversation. I do not see any value in a rejection letter having an extra page appended to it with a list of alternative providers on it. Frankly, I do not think that is going to achieve a great deal. More engagement would be hugely helpful, but I will go back to the point that I was discussing just now about the smaller applications that are dealt with in quite a mechanistic way. I have some concerns there.

Q63 Amanda Milling: Is that the way the banks will end up going: "Here is your rejection letter and here is the list of finance options"?

Andrew Sandiford: I do not know. It is my fear that that is the way it might go.

Q64 Chair: This is an important point. Why would banks want to say to a rejected applicant, "Here are our competitors, and you might go there and get all your banking services, and we are signposting you in that direction." There is no real motivation, so how will it work? How will this be enforced?

Andrew Sandiford: To Simon's point, they are not necessarily competing in all arenas. That is part of what we now have in this very complex market. There are different providers for different parts of the market. I do not know how it will work in practice. I do not know what the banks are planning. I have not discussed with the banks how it will happen.

Q65 Chair: In your experience with your clients, do the challenger banks have a lower risk profile?

Simon Littlewood: I do not think so. There is a real danger of assuming that, because someone puts an application into a bank, they should have money. It is perfectly fine to say, "That is not a sensible thing to do with either Government money or somebody else's money." To put that in context, last year, on the largest crowdfunding platform in the UK, over 95% of applicants were rejected. It is an important point: some things are rejected for the right reasons.

Andrew Sandiford: I would echo that. Bank finance is not the right answer every time either. Crowdfunding—be it equity funding, debt funding or asset-based lending—may well be a better answer. Just because 10 years ago it was always the overdraft or the short-term loan does not mean to say we should be striving to get back to that today.

Q66 Kelly Tolhurst: I have a small point about private investors, mainly regarding Mr Sandiford's experience. I have seen the market change over the last 10 years in regard to being able to access private finance, which 15 years ago was probably not really an option for small business. In your experience, with your clients, have you noticed that there are people now looking far more to invest? You may have seen that across your client base, with the different markets that you are in. Has there been an increase? Are people more willing to take risks with their private investments to help other organisations?

Andrew Sandiford: There are a few different areas. Crowdfunding is working for a number of businesses. These are very small clients. One example is a retail operation set up in town. It was a little quirky and different; crowdfunding worked extremely well for him, and he had no shortage of applicants to back him, because it was a good proposition. At the other end of the spectrum, a luxury product business looking for a multi-million pound deal found a private individual who just said, "Yes, I have X million pounds and I am prepared to put it into this business." There are people out there looking to invest, undoubtedly. They will say the challenge is finding the good businesses to invest in.

Q67 Kelly Tolhurst: I know it is anecdotal, but from your experience has the number of people willing to do that increased significantly over the last 10 or 15 years?

Andrew Sandiford: It has, and it is a reflection of a number of things. The demand is clearly there; interest rates are low, so what else are you going to do with your money? People are more willing to invest. I think there are more people out there prepared to do so.

Simon Littlewood: We were involved a little in the SEIS developments, and I absolutely agree that there is more willingness to explore. The success of the EIS schemes has encouraged people, just in terms of conversation, so that awareness has grown. Interestingly, the classification of those as high-risk investments by the FCA meant that, were normal IFAs—independent financial advisers—to advise any client to put money into those, it would have had an impact on their professional insurance premiums. If you imagine they are a large representative of the market and, as trusted advisers, influencing whether people are putting money into those things or not, some made the choice not to pay the additional premium to be able to do that.

Q68 Chair: Kelly has raised an important point in respect of the flows of finance. We are looking at access to finance and any problems. Is the problem with access to finance not a funding gap but an information gap; that we are just not getting the right routes in terms of marrying up people who want to invest with the people who require the capital?

Simon Littlewood: That is certainly our experience. As you say, 87% of the businesses coming through that were prepared to take advice were successful in raising their finance after application. That is not because it was transformative; their business plans did not change wildly; they did not change things. It was about some support in terms of that and alignment with appropriate funders, and knowledge of what those funders were looking for. As you say, it is that matching service.

Andrew Sandiford: I would agree. Those who seek advice and have access to the networks and knowledge are successful. That is critically important.

Q69 Chair: So there is plenty of money to go around. It is just making sure that capital identifies potential in businesses.

Andrew Sandiford: It is a big statement to say there is plenty of money to go around, but in our experience those who take advice have a good chance of finding what they are looking for. It might not be from where they expect it, but we will get them to the right place.

Q70 Chair: We heard from the first panel, and as a theme throughout many of our inquiries, that there is a small and undeveloped venture capital ecosystem in this country, certainly relative to the United States. Is that fair?

Simon Littlewood: I am not sure it is that small or that new. We really started proper VC-type investment in this country in 1983. What is interesting is the appetite to back particularly high-growth ventures at a particular point. There is lots of private equity in terms of established property deals and big familiar-type large funding investors.

There is a gap relative to the States or others around that second tranche of investment into high-growth scaling businesses where, frankly, it is easier to go to somebody. We had an international investor in my own business, because we were interested in their ability to take us to a global scale. That is really appealing and why we see companies like Huddle getting to a certain stage and then taking investment from Matrix and others from the US coming into the UK around Tech City. Where you are making a decision for that type of money, having somebody who has the experience of doing that a number of times is more appealing, so they tend to exist elsewhere.

Q71 Richard Fuller: You were sitting in during the previous panel’s evidence. I just want to clarify where you see the second stage. By that do you mean Series B and the £10 million to £25 million like the previous people, or do you have a different view?

Simon Littlewood: I am not suggesting there is necessarily a gap in the funding. I am just not sure it is provided by UK venture funds. You can find money, but it might be an American-backed fund.

Q72 Richard Fuller: I appreciate that. I just want to get the scale. Is £10 million to £25 million—second round funding—the area you are talking about in terms of scale of investment?

Simon Littlewood: That sort of space, yes.

Q73 Richard Fuller: Within that, is it an issue specifically for high-growth businesses, or is it a generic issue? It could be a construction business that wants to build a new wing to its widget factory.

Simon Littlewood: It is focused on high-growth businesses rather than established sectors, where effectively there are similar models operating at different scales, whether it is property or construction. You have PE houses that already have the financial models that help them make their decisions.

Q74 Richard Fuller: Sorry, I was making a slightly different point. One company is essentially looking to add a new production line for a new product or way of packaging its products versus, on the same scale of investment, one that has just £500 million revenue and is losing £3 million but growing 500% a year. Is the funding gap at the next round—£10 million to £25 million—the same problem for those two examples, or is it industry-specific? We heard earlier it was sector-specific too.

Andrew Sandiford: There has to be a significant growth dimension for those equity investors to be interested. That goes without saying. Drawing on personal experience, two clients of a similar size were looking for a similar sort of investment—at the bottom end, but in that tier B space. The first, because it is a far more attractive business with a much better growth story, had I think seven proposals from private equity houses, and the second did not get a single proposal, because it was construction, broadly speaking, and people are scared of construction as a sector.

Q75 Chair: We have talked about sectors and whether there are particular sectors that are unfashionable and unloved by potential investors. What about regions? In your experience—and, Simon, maybe in terms of Grant Thornton being national—do you find that the further you go from London, the more difficult it is and the less developed that ecosystem is? This is in terms of not just VC but also banks and what they do.

Simon Littlewood: I am very happy to submit some papers with some evidence to follow this, simply because there is a wealth of evidence we have exactly around the regions, by LEP, of different types of funders, where the Business Bank supported and the rest of them. I will leave some of this with you, but there is some variability. My concern is that the regional focus might result in a business in the north-east not being aware of the opportunity of funding in another part of the country that would be absolutely appropriate for them. There are absolutely regional focuses and different sorts of elements. Angel finance will tend to be easier to raise in the south-east, for earlier-stage businesses. The slight nervousness is that, without some sort of national connectivity, you are left with the pool you operate in.

That is determined by geography and your postcode, rather than what might be the best source of capital for you.

Q76 Chair: Is that the market failure that the British Business Bank should step into and resolve? How is the British Business Bank going?

Simon Littlewood: In terms of that £210 million that went into a range of businesses at that early stage, the Business Bank and those backed funds were just over 20% of all those funds going to the market, reflecting that that is in the first couple of years of the Business Bank being up and running. I think the Business Bank is making an impact. I think someone else referenced the idea that, if you are doing something, do it and stick with it and allow it to evolve. Be confident in the decisions we have made and let it grow. It is on the right track in that regard.

Andrew Sandiford: The Business Bank is an interesting one. It is something of an unsung hero. If you talk to most of my clients, they probably will not have heard of it, but a lot of them will have been touched by it through the various schemes and the wholesale distribution that they do. I would echo Simon's point; it needs to be given time to flourish, because it has made a promising start and it would be a tragedy to see it terminated in the short term.

Q77 Chair: It needs to be a long-standing part of our financial and institutional architecture. Is it big enough to make a difference?

Simon Littlewood: If 20% of the businesses we are seeing funded through that are being funded by those sorts of funds, it is already having a market impact. That is a good indicator. I am not sure what the future holds, obviously.

Chair: If there are no further questions, I would like to thank you for your time. That has been incredibly helpful. We find that really useful. Simon, if you could send us that regional information, that would be very helpful as well. Gentlemen, thank you again.