House of Commons

Treasury Committee

Oral evidence: SME finance, HC 805

Tuesday 6 March 2018

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Watch the meeting

Members present: Nicky Morgan (Chair), Rushanara Ali, Mr Simon Clarke, Stephen Hammond, Mr Alister Jack, Alison McGovern, Catherine McKinnell, John Mann, Wes Streeting.

Questions 1 - 67

Witnesses

I: James Meekings, Co-Founder and UK Managing Director, Funding Circle; Stephen Welton, CEO, Business Growth Fund; Katrin Herrling, Co-Founder and CEO, Funding Xchange; Luke Lang, Co-Founder, Crowdcube.

Examination of witnesses

Witnesses: James Meekings, Stephen Welton, Katrin Herrling and Luke Lang.

Chair: Good morning. Thank you very much indeed for appearing before our panel this morning. This is our first evidence session of the SME finance inquiry. Before we get started, just for the benefit of those who are watching outside of the room, could I just ask you to introduce yourselves?

Stephen Welton: I am Stephen Welton. I am the chief executive of the Business Growth Fund.

Katrin Herrling: I am Katrin Herrling, co-founder and CEO of Funding Xchange.

Luke Lang: I am Luke Lang, co-founder of Crowdcube.

James Meekings: I am James Meekings, the founder and UK MD of Funding Circle.

Q1 **Chair:** Thank you all very much indeed. We are hoping to get your perspectives on non-bank finance this morning. We have a good cross-section here of the sorts of non-bank finance that are available to SMEs. It would be really helpful, just as an introduction, if you could each briefly outline the role that your particular organisation plays in funding small businesses in the UK.

Stephen Welton: We are an equity investor. We do not lend money to companies; we invest in them and take a minority stake in those businesses to provide them with the growth capital to expand over time. We also put people onto the boards of those companies. We have a talent network now of over 4,000 people.

What we have sought to do over the last seven years is to build a network across the UK, to make sure that we can talk to as many small companies as possible. We now have 13 offices with 150 people, and we are making, on average, one investment per week, investing between £300 million to £500 million per year. We are now the largest growth capital provider in Britain. I suppose the core focuses of what we are trying to do are to make sure that finance is available outside of London—over 70% of our investments are outside of London and the south-east—and, secondly, to work with entrepreneurs, founders and owners of businesses to help them grow for the long term, so very much taking the perspective of patient capital to help grow larger businesses for the future.

Katrin Herrling: Funding Xchange was founded four years ago, to help small businesses actually get transparent access to debt finance. The problem that we are trying to solve is that it is hard for a small business to understand what sources of debt finance are available to them. In the consumer space, we have something like moneysupermarket.com. That type of transparency did not exist for small businesses. We have used technology to give businesses access to more than 50 debt finance providers, giving them a sense of what products they are eligible for, what terms are available for them and their specific business, and thereby allowing them to make a choice of which of the solutions that are available to them are appropriate for their own challenges in growing their business.

What this is about is providing better access, and easier access, to debt finance. We have been recognised by the Treasury. We have been appointed as a designated finance platform, therefore working with nine of the CMA banks to provide access to finance to those companies that have been declined by the CMA 9, and have accepted a referral to one of the finance platforms. We see that there are huge challenges around businesses that are time-poor and often do not understand the finance market, so being very simple and easy to work with to provide access to finance is one of the core, unique offerings that we provide to businesses, making it very quick to see what is available in accessing that.

Luke Lang: Crowdcube was the world's first, and is the world's leading, equity crowdfunding platform. When we established Crowdcube back in 2011, we were primarily trying to solve two problems. The first was plugging the funding gap for start-up, early-stage businesses, initially focusing on seed investment, but more recently that has transcended into more growth finance. Indeed, we have funded £33 million-plus deals in 2017. That is more than any other funder in the UK.

We have funded hundreds of millions of pounds for over 600 businesses, and I guess that I am here to represent the entrepreneurs of start-up, early-stage businesses with real growth aspirations who maybe bank finance is not quite right for. I guess that we are looking to finance and fund the next generation of entrepreneurs: the James Dysons, the Jamie Olivers, the Richard Bransons, and the Martha Lane Foxs. Notable crowdfunding-raisers on our platform include the likes of Monzo, Revolut, BrewDog, Camden Town Brewery, and Sugru, all raising in excess of £1 million on the site. Last year, we raised over £90 million. We are the largest platform in the UK. We have over 500,000 registered investors. That is British people backing British businesses through our platform.

We received unprecedented demand last year, with over 4,000 applications to our platform to raise finance, so it really is an emerging source of finance. It is good for the regions—over 50% of funding is outside of London and the south-east—and it is good for female entrepreneurs as well. Over 20% of investment goes into female-founded businesses. That is more than double what you would normally get from private equity or venture capital. Indeed, female entrepreneurs actually have a greater success rate than their male counterparts. They are 70% more likely to hit their funding target, versus 50% for businesses. It is good for the regions, good for female entrepreneurs and good for diversity.

James Meekings: I am very pleased to be here. We are very passionate about small businesses, so we are looking to help. Funding Circle was born in 2010, after the economic crisis. Everyone who read a newspaper at the time will know that there was a challenge with small business finance. We wanted to use technology to build something that we felt worked better in the interests of small businesses than the banking system did. We set out to do that through an online lending platform. We really championed the "S" in "SME"—companies with an average of 10 people.

We have done a really good job of that, and it is working with small businesses. Through our platform, more than £4 billion has now been lent across four different international markets to about 40,000 different businesses. One of the core themes, which you will hear me say again and again today, is that we want to build a platform that businesses come back to, and use again and again and again. We think that UK businesses should invest in their business, and there is a full cycle of doing that. We focus on experience. We focus on treating customers fairly, and, as a result, I am pleased to say that 94% of businesses that do borrow through us say that they would always come back to us first, and not go back to the bank in the future.

Q2 **Chair:** That is a really interesting place to probe. You have talked about people not going back to banks, James, and I think, Luke, you used the phrase, "Bank finance might not be quite right for them". Part of the reason for this inquiry is that we have heard, particularly in the light of dealings with RBS, small businesses say that they are not prepared to approach banks any more for finance. They want to look for alternative sources of funding. It would be helpful to get your perspectives. I should just say, obviously, that with a panel of four, do not feel that you have to answer every question, but equally, if you do have something, then please absolutely speak up.

It would be helpful to know from your clients, your customers or however you think of them, why they come to you. I think you mentioned, Katrin, that some had been turned down for bank finance. Do they come straight to you now? Have they been turned down? What have their experiences been of dealing with banks, and why are they turning to you? Katrin, perhaps we will start with you, because you are designated an alternative platform by the Treasury. It would be helpful to hear your experiences of that.

Katrin Herrling: If we start with the customers, we are seeing a broad range of customers. We have many different acquisition channels. We are working with accounting firms, we are working with cloud accounting service providers, but we are also working with the CMA 9. I am sure that everyone is familiar with the process: if one of those banks turns down a customer, the customer is offered a referral to one of the referral platforms, and once a customer arrives at our doors, we reach out and we seek to provide alternatives to finance.

What we have learned over the last 18 months through the referral process is that those customers who are coming to us after being declined by banks are often very difficult to finance. We are not seeing a predominance of customers who have been turned down and would easily qualify for finance. It is important to work with these customers to seek alternative sources of finance, but often what we find is that the typical profile of this company is that there are very small amounts of finance that are required. The average size of a finance request through the referral process, for example, is £16,000. It is the very small end, much smaller than the "S" that James would have been referring to.

What we find, in addition to that, is that a high proportion of the customers coming through the referral process are very early-stage companies. Almost 30% of customers coming to us have less than a year of trading record, or are sole traders. These two segments, with less than a year of trading record and sole traders, are certainly finding it very challenging to access finance, not just through banks but also through alternative lenders.

As a very early-stage company, you might not just want to look at debt. You might want to look at the broader ecosystem of funding solutions, if you are aspirational about your growth prospects. You might want to look at equity self-funding, and we find that those companies often do not have a very good understanding of the different sources of finance, outside of the bank loan or the overdraft, that they could access. Thus, there is a problem that we would love to continue to help solve, which is actually more about education of these customers who are driving growth in the economy, and are founding businesses and wanting to grow these businesses, but also need help to understand that there are other solutions than just debt finance.

With the companies that we can help, those that come through the referral process to us, it is very interesting. We do certainly have solutions that help these companies that are often a bit earlier-stage than what a bank would see as an appropriate risk profile, where alternative finance actually does provide very good alternatives from banks. We define these customers as having at least a year of trading record and having no outstanding CCJs. Alternative finance ends up finding solutions for 30% of these customers coming through the referral process. This is 30% of customers actually being funded by alternative finance. This does show that the referral process and working in an integrated ecosystem does create additional liquidity for customers that are not yet quite right for the bank finance solution that they may have applied for initially.

Q3 **Chair:** Luke and James, you both mentioned alternatives to banks in your first answers. Do you have anything to add on customer experiences?

Luke Lang: Yes. From my point of view, equity crowdfunding satisfies a different demand to banks. It is for those aspirational, ambitious, start-up, early-stage businesses that really want to grow quickly and rapidly, and maybe they do not have the assets to back it up with debt finance, or they do not want—or are unable to meet—the interest repayments from a bank loan. The benefits of crowdfunding are widely understood now, as well: the benefits beyond just finance, such as the speed of capital, the opportunity to acquire investors, and the opportunity to engage with your customers and your community, are really understood, and that is what is driving a lot of the businesses to Crowdcube at the moment.

It is worth noting that one in four entrepreneurs that raised equity finance in 2017 did it through a crowdfunding platform, which is quite an impressive statistic, given that crowdfunding did not exist before our launch in 2011. It has had a great impact on the British economy, and has actually penetrated that market. What I spoke about earlier, about diversity, better access for female entrepreneurs and regional access for businesses, has really resonated around the country, as it were. The economic impact is certain, as well. These businesses are creating jobs. They are safeguarding jobs. They are exporting overseas. They are opening new shops, offices, restaurants and cafes, and launching new products.

Certainly, we see from our entrepreneurs that are raising on our platform a real hunger and thirst for crowdfunding investment. The challenge comes when many of these businesses need to be able to bring some of the lead investment with them, so that bias is towards a certain demographic and a certain type of business. What we would advocate is that the Government look to see how they can support the British public through match-funding and through crowdfunding platforms, to help to really energise, capitalise on and amplify the success that we have already seen.

Q4 **Chair:** James, what about your customer experiences?

James Meekings: About 20% to 30% of businesses that borrow through our platform do not think that they could have got finance through the banks. The large share of them say that they could. The question is why they are not. There are two core tenets to that. One is that—and this is a question for you guys to ask the banks later—banks do not really do cash-flow lending to small businesses. They lend against security. That is challenging for small businesses, because lots of small businesses do not have much security to lend against, especially when you are in a service economy, like ourselves. When they do lend, the capital requirements that they have to hold make it less profitable for them to do so. There is this natural position where they would actually prefer to lend on mortgages and other consumer products than put their money to work on businesses. We see that when we look at net lending stats and what has happened since the referendum, which we can come on to later.

In terms of customer experience, that is the second tenet. Small businesses want to run their business. That is ultimately what they want to do. It is a weird and wonderful world of fishmongers, bakers and glamping sites. There are loads of different stories there, and that is what they want to do. The speed and ease of getting finance to invest in their business just puts them off when they go to a bank. We continually hear stories that it takes months for them to get finance through a bank. Through us, it takes 10 minutes to apply online. They speak to well-trained sales professionals in that process as well, so it is not purely online. We then get a decision to them within 24 hours, so that whole process takes away any of the uncertainty.

They get to do it any time they want. What we typically find is that 50% of the initial registrations from businesses happen in hours when they could not get a meeting with their bank manager. The traditional experience through banking does not really meet with the modern world that small businesses are looking for. There are then some secondary things around transparency of fees. There are a lot of different fees that banks may charge. We are trying to be much clearer. Banks are actually making good progress on this, and they are changing. I think that is one of the results of competition.

The last thing on customer experience is pricing. We use data and technology to make sure that we price risk appropriately. That means that we think we can price better than banks on some loans, and therefore that is a better experience as well.

Stephen Welton: I just had one comment, thinking about customers, because we talk about the SME market. It is an incredibly broad term. There are 5.8 million companies out there. Over 90% of those employ one person, so the customer experience for a person running a sole trader—a baker, or some of the businesses that James has talked about—is very different from that of a business that is employing 50, 100 or 200 people.

In looking at the customer experience, you have to look at almost an escalator. What is it that you need for somebody starting up a business tomorrow on their own? That is going to be seed capital from friends and family, and government tax policy, in terms of the EIS and the Seed EIS, is really working. The birth rate of new businesses in Britain has never been higher, and that is clearly a signal of success. We are creating small companies.

What is their funding after that? The banks have a role to play. As James has said, banks obviously lend money with the expectation of getting it back. There is nothing wrong with debt. There is obviously something wrong with too much debt in a business, which is why you need to have alternatives. The system we have now is a lot more positive than it was when we started in 2011. We were all founded pretty much at the same time. Alternatives are increasing.

What we need to do a better job of is increasing the understanding in the SME population as to where to go, because one of the frustrations is if you think that the solution to your problem is an overdraft, and you go and ask for an overdraft and you do not get it, that does not mean that you cannot raise funding. It means that you have gone to the wrong place to get funding. There is a big educational piece that we need to do.

From our standpoint, the start-up environment in the UK is very healthy. Where we have a significant challenge is in scaling up the start-ups that are successful. There are approximately 30,000 to 40,000 out of the 5.8 million that would be defined as scale-ups, and these are the businesses that have significant economic potential. They will hire a lot of people. They will do a lot of exports. We are not doing a good enough job scaling them up, and there is a funding gap there, in terms of the amount of risk capital and bank finance to get those businesses to be the global companies that we are all aspiring to. That is something that we want to try and focus on: how we take the successful start-ups that we are creating and turn them into successful international businesses.

Q5 **Mr Clarke:** Stephen, just to carry on from where you were leaving off there, you talked about the big educational piece that needs to be done to alert people to all of the options that are available. What comes out of our brief is the lack of awareness that often characterises business' understanding of the various options that are open to them. That being said, how do we counter that? Stephen, do you want to lead on that?

Stephen Welton: Clearly, we would have had this debate five or 10 years ago. There are some positive things. The fact that millennials all want to set up their own business is actually true. The fact that we have so many new companies being set up is a very healthy sign. Generationally, the younger generation are more attuned to setting up your own business. Clearly, you need funding to do that; therefore, they will go and look for it. The best example of that would probably be in London, if you look at Tech City.

There are some positive signs, but technology and the technology sector is one part of the economy. We have to be able to reach to all parts of the economy. How do you get to the manufacturing businesses and more traditional companies? You have to try to address some misconceptions and some fears. The misconceptions are that the banks will not lend money to you, and if you do go, it will take months and you will not get anything back. I think that banks are trying hard to improve on their own service. The other big gap is, "What if the bank is not right for me? Where would I find that funding?" The new platforms that are emerging are clearly attracting customers, investors and borrowers, and that is a good thing, because it increases awareness.

In my mind, the real answer to this is to move from the very big macro picture to the local picture. What we have found very successful, and the reason why we have so many local offices, is that the way to build relationships with entrepreneurs is to get to know them, and to get to know them over time. An equity investor takes a stake in your business, and that is a genuine form of partnership, so you have to feel confident about them. That is another reason why we have close to 5,000 independent directors across the UK now, who all live around the country. They know people. It is this sort of networking effect that will take time. That is improving. I do not think that it is going fast enough, and clearly there is a role that the Business Bank is trying to do with their new digital hub to bring together information sources.

For somebody who is non-financial, it is often quite intimidating to try to find funding. You do not know the language. It feels like a very opaque system, and you think that you are not necessarily going to be right for the person you are applying to. I think that we can start to break down those barriers. It is about consistently repeating messages: what it is that we do as an investor, which is clearly very different to somebody referring applications from a bank that is not supporting them, or to a crowdfunding platform. I would absolutely welcome inquiries like this, because you are shining a spotlight on, "What is the problem here?" and, actually, some solutions are emerging.

Q6 **Mr Clarke:** Katrin, to touch on what Stephen was saying there about the fact that inquiries like this are useful, do Government have a role to play in helping to clarify what the sector can actually look for, in terms of finance?

Katrin Herrling: What the Government have done very well is to create an ecosystem that provides access to many different sources of support, be it tax, benefits, R&D tax credits, SEIS, EIS, or innovation grants, and now innovation loans. We can go on and on. Where the Government have done a great job is identifying friction in the market, and saying, "Here is a way to address the friction".

What this has created, though, in my mind—and I agree with Stephen—is a situation where the transparency and the ability to access these measures is now almost holding us back from these measures actually reaching the companies that could most benefit. As we move into the next phase of making these instruments available, one of the areas where there could be more focus is how we create transparent access for businesses that are not super-sophisticated and will not have a PhD in finance, to understand which of these measures are right for them so that they benefit.

What we are doing in terms of, for example, having start-up loans integrated into the Business Bank is great. There is more co-ordination already in the system, but we now need to think about a single business coming and wanting to access these different measures, and how we make that as seamless and as easy as possible. At 8 at night, when I, as a small business owner, start engaging with my finances, I should have a way of understanding that these are three things that should be relevant for me, and how I go about exploiting these for the benefit of my company.

Q7 **Mr Clarke:** Luke and James, part of the problem is awareness. Part of the problem is also confidence, because this is a more unfamiliar world. It is potentially seen as more high-risk. Given that you are at the front line, how do you imbue that confidence that you are not just an available option, but a safe option, to come to for finance?

James Meekings: I will take that first. You highlight a very good point, which is around trust. Even now, when we are regulated and we speak to businesses, they want to know more about us, and that is only right. We are doing KYC and AML on these businesses. The Government have done a very good job of helping to lay the foundations for us to succeed on this front. There is a bigger question here about what the role of Government is. I do not think that the role of Government is to be doing our marketing and advertising for us, as much as many people would say that. It is to set the right foundations in terms of regulation and making sure that there is not friction, as Katrin said. The Government have done a good job of that.

It is really important that there is a level playing field between all of the different forms of competition in the market. There is probably a bit more to be done on that front, which I can speak through. Regulation builds trust, at the end of the day, and so we have always been proactively trying to get more regulation, to protect consumers but also to help us to build trust.

Q8 **Mr Clarke:** What regulation do you feel is missing at the moment that we do not currently have?

James Meekings: I would not say that there is regulation missing. The regulation is in a good place to protect consumers' interests, et cetera. When I said that there is more to be done, I was more referring to there being a level playing field between us and banks, and specifically in what we can and cannot do. For example, one of the things that we would like to see—and we are working with the Bank of England on this—is for our investors to be able to sell their loans to the Bank of England: to make those loans central bank-eligible. Banks can do that. Our investors cannot do that, and therefore that creates a distortion in liquidity across markets.

Luke Lang: Regulation plays a huge role in building trust. When the regulation was introduced for crowdfunding back in 2014, that was a watershed moment. The FCA deserves a lot of credit there for balancing the need for stimulating competition and new markets with investor protection. The UK leads the world in FinTech, and particularly in peer-to-peer finance and equity investment-based crowdfunding, so I think we deserve a pat on the back there.

In terms of confidence, the banks have been around for 250 years, so cut us a little bit of slack. We are trying really hard. If you look at awareness levels, as well, the British Business Bank report noted that equity crowdfunding awareness grew rapidly from 2014 through 2015 and to 2016, which coincided, coincidentally, with when Crowdcube was investing heavily in marketing campaigns. I am sure that James has similar tales from Funding Circle.

I agree that it is not down to the Government to do our job on advertising and promoting our wares, as it were, but there certainly is confidence. As I said earlier, one in four entrepreneurs that secured equity finance in 2017 did it through a crowdfunding platform. That is a real signal that they have confidence in crowdfunding, in our industry, and in the benefits that it can have for their business.

James could probably speak at length about the benefits and the impact that it had on Funding Circle when the Government started to invest, co-invest and match-fund alongside retail investors through Funding Circle. That had a big impact on their business. It increased the liquidity to those companies and increased their certainty of funding. The Government are stuck in a time warp to some extent, where they are not recognising the role that equity crowdfunding is having in funding start-up, early-stage, high-growth businesses. They need to.

Q9 **Mr Clarke:** I am conscious of the lack of time. That leads me on to my final question, which is that undoubtedly there is progress, and this is hugely exciting. I was encouraged to hear what you were saying, Stephen, about the fact that over 70% of what you have been doing has been concentrated outside of London and the south-east. I am always conscious that areas like Catherine's and mine in the north-east, for example, can feel like an awfully different environment, both in terms of the businesses that are being served and also, obviously, the relative distance from London and from the centre of finance. Is this something that any one of you might want to lead on? How do we counter that regional imbalance?

Stephen Welton: You have to do it in a very old-fashioned way. Technology is fantastic in terms of speed, assessment and analysis, but there is no substitute for personal relationships. We opened, in the last few months, offices in Nottingham, Belfast and Cardiff. Why have we done that? Because we will get closer to business owners by being in that proximity. We are not yet in Newcastle, just before you ask me that question, but we do a lot in the north-east, and it would be one of the cities that we would think about.

The way that we have set up our offices is to do our homework, as it were, in terms of how many companies there are in that region that we think we can help. We are looking for businesses that have the potential to scale up. Physical proximity does matter. Building relationships does matter, and one of the things that we have found most powerful is that with all of the independent directors, who do not actually work for BGF but work with us, there are a lot of very experienced businesspeople across the country who are keen to support young businesses and help them to grow.

We are talking about raising funding. What you do with that funding is absolutely critical. I do not think that we have seen any business plan that has ever been completely met. They are all very aspirational, and that is the real world that we live in. Bringing people in from the outside to work with entrepreneurs and founders is incredibly powerful. It is also another way to increase awareness and to reduce the concerns about, "What does this mean for my business?" We are moving in that direction, but we have to keep pushing very hard; otherwise, inevitably, funding gravitates around London. There are a lot of very successful businesses outside of London, and our most successful region is in the north.

Luke Lang: Just to add to that point as well, I am based in Exeter. Crowdcube is headquartered in Exeter, so we are very proud and passionate to support and champion the regions. We have a regional growth strategy, where we are working with partners to try to push the message out further and wider.

It is an important point. It is not just about London; it is not just about tech; it is not just about men in Silicon Roundabout. The VC community reflects the companies that they invest in. They tend to be white, they tend to be male, they tend to be investing in tech, and they tend to be investing in businesses in London. We need to break out of that cycle. The second biggest region outside of London and the south-east for Crowdcube is the south-west. There is a causal relationship there: that is where we are based and that is where we have greater awareness.

Mr Clarke: On that note, I will just close by saying that you are very welcome to come north whenever you want.

James Meekings: I just wanted to add to that. I have a slightly different view, which is that London has an amazing depth of talent. It has financial services, it has technology, and there are 10 million people that live in this city. That makes it really easy to grow. That does not mean that the businesses that we support are all in London, by any stretch of the imagination.

On the relationship point, every business that borrows through Funding Circle gets a relationship manager and speaks to them on the phone. They always laugh, because they say, "I thought this was online, but actually I have spoken to you more through this application than I have spoken to my bank manager in the last 10 years". You get this relationship that is driven by connection, and that can happen on the phone as well.

We actually over-index in the north-east. We follow SME population all over the country. We over-index in the north-east, because that is where banks are closing the most branches. Banks closed 780 bank branches last year, which was 10% of all bank branches. Actually, banks are moving away from the world that Stephen talks about, because as a mass-market product, it does not work very well. It does work in the way that Stephen is doing it. I am passionate about helping all small businesses across the country. I think that we can do that through online platforms. I would not want you to think that, because we are based in London, that makes us unable to do that.

Mr Clarke: That is really helpful. Thank you very much.

Katrin Herrling: One other way that technology can actually help is that, for example, we have a very positive relationship with the Development Bank of Wales. We are actually able to isolate customers who are relevant for regional lenders and ensure that they are getting access to those quite segmented solutions that are available for specific, regional businesses that are coming to us, which may find it more difficult to access finance in a different context. We encourage those regional development efforts, and we believe that technology has a role to play there, even though we are not yet present physically in Wales.

Chair: Very interesting. That is great.

Q10 **Alison McGovern:** You have all said very interesting things so far. This is a very important subject. Unfortunately, I will have to leave shortly after I have asked my question, so please do not interpret that as lack of interest. I just have an incomprehensibly difficult diary, so my apologies.

I just wanted to ask first about consolidation in marketplace lending. There was some data that showed that in 2017, 94% of all marketplace lending to businesses originated from just three lenders. I wondered whether Luke and James in particular wanted to comment on why you think that that consolidation has happened.

Luke Lang: You go first. You have the biggest market share.

James Meekings: Competition is really important. Giving choice is really important. In the small business lending market that we operate in, we are still less than 2% of the market. Banks dominate this space completely. All that we are trying to do is to rival banks and give them more choice.

Now, within our space, we are a leader. There has been no consolidation with us and other players in the UK, but you are not going to end up with a world where there are 10 different online lending platforms in one place. I would not want that to seem like there is not competition, because actually we are less than 2% of market share. When you think about competition and driving things forward, there is a long way to go for us.

Q11 **Alison McGovern:** Is it just that you are competing with the banks? That is where the effective competition is coming in.

James Meekings: We are less than 2% of gross lending, so that is where we are focused. The biggest challenge that we have is getting small businesses to not think "bank" first. That is what they do. How do we break that down? That is where the competition comes. There are new start-ups in our space, but we are focused more upstream than downstream.

Q12 **Alison McGovern:** Just thinking about the banks, what would you say that their competitive advantage is? It may be that it is just as you said: that there is that default thinking of, "I want a loan; I go to a bank". Do you think that they have any other advantages that they are exploiting?

James Meekings: Everyone has a bank. Every small business has their bank. We bank with a bank—I will not name them—and we have 30,000 businesses in the UK. They all have direct debits that pay back into our bank. If we wanted to change our bank, we would have to move each one of those direct debits. If our bank says, "No", to giving us finance, can you actually go to another bank? You cannot, really, because in the very need to go and get yourself financed, you put the greatest financial risk on your company by moving it across. Competition within banking is actually really difficult. You have to swap all of your banking just to get a loan from a different bank.

What you actually need is non-bank solutions to complement banks, and that is why we have partnerships with banks. We have partnerships with RBS and Santander, and they want to keep that banking relationship. They want to sell the insurance. They want to sell the foreign exchange. They want to cross-sell everything, but if they cannot do the lending, they do not want to lose all of the other stuff. The biggest advantage that they have is the plumbing, and how tied-in to them SMEs are. That is why I think that the open banking initiatives that the Government are pushing are really exciting, because they are going to unleash more innovation and competition without businesses actually having to move bank.

Q13 **Alison McGovern:** That is really helpful. Just say a little bit about government support. People have mentioned that they think that the Government have done pretty well in terms of supporting alternative finance. Is that right? What kind of support has there been from Government?

Luke Lang: The Government, through the BBB, have done a brilliant job of supporting Funding Circle and supporting the venture capital community. They announced £400 million to go into VC funds in November 2016, and backed that up with another £400 million at the beginning of this year. I just feel that it fails to reflect the reality of what is going on, and plays to the VC community somewhat being biased towards London, biased towards men and biased towards tech firms. The Government are missing a trick to actually better reflect what is going on in the real world.

As I have said many times, one in four entrepreneurs who raised equity finance in the UK last year did it through a crowdfunding platform. To your earlier question, there is great competition in that market. It is extremely vibrant. There are two or three leading players there. I do think that the Government are missing a trick there. It had a huge impact on Funding Circle back in 2013-14 when the Government intervened there, and I think that it could have a similar impact there. You have hundreds of thousands of British people backing businesses that they really believe in, from London right across the UK and into Scotland. It is time that the Government stepped up and started matching that investment.

Q14 **Chair:** In terms of competition, do you think that there is more competition for certain types of businesses? Back in the days of the recession, I saw anecdotally, certainly as a constituency MP, that particularly businesses that were exposed to property, and so had interests, had more difficulties with their banking relationships than, perhaps, others. Do customers report that, depending on the type of business that they are running, they are getting more or better offers of financing?

Stephen Welton: A company that is doing really well will always raise funding. You need to focus on those that are struggling, whether that is due to the state of the economy or the sector that they are in. There tends to be a very heavy focus on technology, but every company is technology-enabled. A business that is not technology-enabled is not going to exist.

If you look at what the venture capital community, in large part, is looking at in London, it is a very similar sort of thing. We are all looking for the next Facebook or Google, and hopefully we will find them, but there are a lot of other businesses as well as that. There is an element here of a glamour parade: if you are in the glamourous sector, then everybody is going to want to meet you, and if you are manufacturing or doing something more traditional, that is maybe not as exciting. The oldest company in our portfolio is in Stoke, which is Dudson, the ceramic manufacturer. It is ninth-generation. It is over 200 years old. We think that that is exciting, because they can continue to grow, so attitude is important.

It is harder, but there are changes that are happening. Businesses are created with fewer assets now. Banks do secured lending, and if they do not have the security, it is going to be harder to raise traditional secured financing, which is why alternatives are so important. That is why crowdfunding, in terms of small amounts of equity or peer-to-peer lending, will drive that through. We do not have a representative from the asset-based financing sector.

The market is better, but it will always be harder for businesses that are not seen as quite so exciting. Our standpoint is that every business is exciting if it has a growth plan. We have the largest independent window-cleaner company in the country, and that started in Yorkshire. Two brothers started cleaning cars, and now they clean quite a few things. That is a really exciting business, because it is growing, so we need to associate excitement with growth, and that is with people. We need to ask what the right type of funding for them is.

Luke Lang: Just to add to that, food and beverage has always been a big sector for us. They are massively underserved by angel and venture capital communities, but performed really well on crowdfunding platforms. They have communities. They have a customer base. They have fans, evangelists for their products and services. They are good at promotion, marketing and branding, so they tend to do really well.

Katrin Herrling: One of the points that I want to pick up from Stephen is thinking through the changing shape of the UK economy, and how that is impacting needs for funding. One of the key trends, which I think you pointed out, is that there are more companies that are not asset-rich, and will therefore find it harder to work within the existing risk models that banks, for example, would have.

There are other trends as well, which are really important to recognise. One is the trend towards self-employment. We will see more and more of the micro-companies. I know, Stephen, that they are not the scale-up companies that would attract equity investments, but they are becoming more and more part of the real economy. Half a million companies are being started up that almost fall into the self-employed sector every year. Providing access to finance for those micro-companies is going to be just as important to help the economy to flourish in the future. We should not overlook, therefore, issues around how we finance sole traders, effectively. It is not as glamourous and it is not as exciting, but it actually makes a real impact.

It does also speak to the need for more diversity in the risk models that we are seeing, and this is one of the constraints that I see as we move into a world where we have less competition in the alternative finance sector. We do see, as a result of concentration, models winning out that have mass appeal, but also are very well-financed and where there is clearly the proposition that resonates with customers. What it hopefully does not lead to is the diversity of different lending solutions that are available being crowded out of the market.

The risk here is probably amplified, as we are seeing that the cost of acquisition for customers in the market is very, very high, therefore making it easier for incredibly well-funded companies to attract and build the scale that they require to deliver a successful business model. At the same time, that does reduce the diversity that has flourished and the ability for a 1,000 flowers to bloom, and to actually see that there are different models that are developing that are supporting different segments of the market. There is a question here about where the friction is. The Government may be able to help facilitate greater access to finance, and specifically in these less glamourous segments, there are opportunities.

Q15 **Stephen Hammond:** Good morning. I was looking at the Cambridge

Centre for Alternative Finance report, and it commented on a number of things. One of the things that it commented on was that although the main force of alternative finance remains retail, they noted an increasing element of institutional investors, investing through market-based lending platforms. That raises two questions initially. One is whether you have an explanation as to why we are seeing that, and whether that is a trend that you would expect to continue.

Stephen Welton: Maybe if I pick that up first from an institutional standpoint, and just to Katrin's last point, it highlights that there is not one size that fits all for different companies. The sole trader is a vital part of the economy. They need access to finance in a different way from a business in Cambridge.

What we saw last year with flat bank lending was a significant increase in equity funding, and a lot of equity funding coming from outside of the United Kingdom. It was over £5 billion. That is encouraging at one level, but I also think that it highlights a significant problem. If you look at the equity funding industry now, we are doing really well, as I was saying, in terms of EIS and Seed EIS, and crowdfunding is a good example of that, in terms of bringing in private retail investors. We are not doing nearly as good a job with institutional investors.

There is a real need to look at the UK industry from a macro standpoint, because it is a cottage industry. We have a lot of very small funds. Most funds are less than £100 million. With less than £100 million, they cannot employ very many people and they cannot invest very much. If we are truly to create really big businesses, we need to think in a totally different dimension, and there are many reports saying that the funding gap is anything from £3 billion to £6 billion per year. There was a report last week by Civitas that said it was between £10 billion and £20 billion.

What that is highlighting is that the major sources of capital in this country—and that is not Government—are the long-term investors, namely the pension funds, and they are not putting enough capital into supporting small businesses. That is where there is a significant opportunity, because the capital exists in the UK. We need to address the question of risk, because obviously, supporting small businesses is risky, but it is not a good enough answer to say, "It is too risky for us to do this". If you look at the local authority pension funds, there are 89 of them. Collectively, they have over £200 billion of assets. How much are they doing to support local businesses in their areas? There is an institutional opportunity.

Q16 **Stephen Hammond:** You raise a very interesting question about how pension funds support not only small businesses but infrastructure, for instance. We could spend a whole afternoon on that. Could I just stick on the point about the institutionalisation of market-based lending platforms, and ask anyone but Mr Lang whether that is a trend that you recognise in your own businesses, and whether it is a trend that you would expect to continue.

James Meekings: Clearly in our business, yes. Luke has mentioned today that the British Business Bank started lending. So far, it has lent £100 million through our platform. The purpose of that was to help catalyse institutional money coming in to support small businesses. What is clear is that whether it is retail or institutions, there is an appetite to help small businesses and to earn yield in doing that.

We have been going for eight years now. We have proven our credit assessment, and we have enough data. We have done enough stress testing of what happens in downturns, et cetera. Institutions are coming to us, and when I think about who is lending today, about half is retail still, and the other half is made up of the Funding Circle SME Income Fund, which is listed on the London Stock Exchange. That actually puts us under greater scrutiny, greater regulation, et cetera, which is good for the protection of retail. That lends across all of our geographies. We launched the first small business securitisation since Lloyds in 2012, so we are stimulating that market again. We have pension funds that lend, which buy into the SME Income Fund.

Q17 **Stephen Hammond:** Sorry, I do not want to cut you off mid-stream, but the question then arises: does the fact that you have different types of investors change which opportunities are available to companies, and does it affect your lending practices?

James Meekings: Not at all. We have to be very clear. Conflicts of interest are a very important part, and we are regulated on that. Also, when investors come to us, they are asking how the loans get allocated between them. We have a dispatch manager tool, which essentially randomly allocates loans, so there is no choosing. Everyone takes a passive slice of them, and then we monitor the performance after that.

To go back to a point that Stephen made earlier, we also have Aegon, a Dutch insurer, which has started lending £165 million. It is going to become a multibillion-pound programme. We also have some wealth managers in the US supporting the UK business. The amount of capital that is coming to support UK business through us is global, and that is why one of our unique selling points is being a global platform. I think that there is a need—I just see this on ourselves—to push out to more British pension funds and British asset managers to help support more small businesses.

Q18 **Stephen Hammond:** Is that your experience, Mr Lang?

Luke Lang: No. Our experience has been very contrary to that. We have not had any money invested from the British Business Bank or the UK Government.

Q19 **Stephen Hammond:** Or from what you would classify as institutions, as opposed to retail?

Luke Lang: No, no other institutions. Institutions often participate in crowdfunding rounds on our platform. That is commonplace, where the crowd will co-invest alongside a VC that is backing a business. That is quite commonplace. What James has articulated really clearly there is that when the BBB first started to invest through Funding Circle back in 2013-14, that really did act a catalyst that unlocked a lot of investment from other institutions around the world. The UK Government are missing a trick by not repeating that measure in equity crowdfunding.

Q20 **Stephen Hammond:** It is quite interesting, because if you look at that Cambridge report as well, it also tends to suggest something quite contrary to what you have both just said to us, which is that there is not much international or non-domestic element of the institutional crowdfunding space, or market lending space. Mr Meekings, can you just comment on that? It is quite different from the trend that they have commented on.

Luke Lang: Certainly on Crowdcube, we have had international investment from over 100 companies, but it is the minority of investment going through the platform. It is probably about 5% or 6% of the total capital, so it is very much British people backing British businesses on Crowdcube.

James Meekings: All retail is UK-based. Maybe the article was discussing that. From an institutional perspective, we have global investors who lend across all of our different markets, so our experience would not fit with what they were experiencing.

Q21 **Stephen Hammond:** Could I just ask you another question, Mr Meekings? Obviously, it was reported in the papers that you intend to have an ISA. I think you made some point about expecting that—not yours, but the market—to raise hundreds of millions. Could you just talk a little bit about that, and what your experience is? It has now launched, as I understand it. Is that right?

James Meekings: Yes, it has. It has taken us many years to get here, but we are very excited by it. Since we have launched, retail investors have earned 6.4% through our platform, and when we went to the Government—I think in 2012—and the Government asked, "What can we do to help?" there were three things that we said. One was about the British Business Bank, the second one was about regulation and the third one was about ISAs, because we felt that if people were doing this already today and earning good money from it, if we put it into ISAs, then clearly more money is going to help support more small businesses.

We launched that in November. Tens of millions of pounds are already going through it. It is something that we are gearing up for ISA season. It is another way that the Government have actually been very successful in helping get more money into small businesses.

Q22 **Stephen Hammond:** What sort of potential do you see for this product?

James Meekings: There are hundreds of millions going through it. There has been some press saying, "Oh, it started quite slowly". What people have to recognise is that we are not banks. We are platforms that have to manage supply and demand. We will go out and market ISAs when there are loans for them to be lent on. It is not as simple as saying, "Okay, it is ISA season. Everyone put all of your money in now". We have to be much more rigorous about it. We have to manage our liquidity, and that is, first and foremost, what we need to do, because it is the right thing for our customers.

Q23 **Stephen Hammond:** Can I just press you? Obviously, "hundreds of millions", can mean all sorts of things. Are we talking about, "In year 1, we have raised £100 million, but in year 5 we expect it to be £750 million?" What do you mean by "hundreds of millions" out of your ISA product?

James Meekings: I think that ISAs will be incredibly successful. I think that hundreds of millions will happen in the first couple of years.

Q24 **Stephen Hammond:** In preparation for this inquiry, I spoke to a number of VC funds, and some of them were raising an issue that is causing quite a blockage in the market, and I wonder if you could just comment. This is probably for Mr Welton, but I do not know. Under the change of the qualifying rules that came in in the Budget—I think in this year's Budget—you are seeing VCs ready to lend to businesses, but whereas the Treasury used to take eight weeks to clear a request, it is taking something closer to 18 weeks now. Is that common or uncommon? Is that something that you have experienced? Obviously, that is causing a problem in terms of getting that funding out to SMEs.

Stephen Welton: We can obviously come back with a more detailed specific answer on that in terms of the industry, but, in our own experience, that is not a limiting factor in terms of the companies that we are backing. That is because BGF invests off our own balance sheet, so we are not a tax-driven investor. We actually invest using our balance sheet, so we do not need tax clearances. Clearly, individual entrepreneurs will.

Q25 **Stephen Hammond:** But for EIS it would be different.

Stephen Welton: Yes. We back businesses that have EIS funding, but again, our funding is not in any way tax-advantaged. Clearly, the Treasury will always be looking at whether the tax reliefs are being allocated in the right place. In the context of VCTs, there have been changes over the years, as you will be aware. Is it actually taking true risk, or is it just taking advantage of tax relief? There is a constant dynamic there to ensure that that is the case. What we do want to see is that VCTs and EISs are actually targeted at growth capital, so it is actually supporting true risk and companies that are not necessarily going to succeed. Our experience is that that is not a limiting factor, but we are very happy to come back with some more detailed views on that.

Stephen Hammond: That would be extremely helpful. Thank you.

Q26 **Rushanara Ali:** Good morning. I wanted to talk a bit more about the role of banks. The word "trust" has come up a few times already. Do you think that in the businesses that you interact with, the level of trust has started to improve over the last few years, or is it still an issue in terms of their attitude towards banks and going to them for loans?

Katrin Herrling: We speak on a daily basis to small businesses that have had a positive experience with their banks, but we also speak to businesses that may not have had a positive experience with their bank. We do see conflicting evidence in terms of what this has done to the trust that a business has in a bank. One really interesting observation, or study, that has come out recently is that in the context of open banking, if you ask a small business who they would be willing to share their data with, they are still trusting a bank more than any other entity. There is clearly still a relationship that, at its foundation, does not seem impaired.

Q27 **Rushanara Ali:** Is that because they think that open banking does not have the same regulatory oversight that traditional banks do, or is it newness? What is driving that?

Katrin Herrling: You are absolutely right. There is a question about what type of trust, and what relationship, banks and small businesses actually have nowadays. Your question is very pointed in this way. I do believe that the relationship is actually changing. The type of small businesses that we are dealing with are often not served through a relationship model. They are looking for a utility service where the utility works. As part of that, they expect data protection to be in place, data to work, and the service to be provided quickly and easily accessible. That is a change in the relationship, particularly at the smaller end, where the expectation of the businesses has just been readjusted to what the banks are able to deliver. They are still seen as being reasonably competent in delivering that service.

James has a point that many businesses still opt out of this service experience and may choose to work with a more flexible, faster provider that provides a service that feels easier.

Q28 **Rushanara Ali:** Would anybody else like to come in on this point?

Stephen Welton: It is a really interesting point, because it goes beyond just banks. It goes to the point of trust. If you speak to many small businesses, they would not have the nuances of what a platform is, what a bank is and what an equity investor is. It is all money. It is often seen as a very opaque world, and it is quite an inaccessible world. If you are running a business, you are not used to raising money.

Through the financial crash and ongoing, there is an element of trust that needs to be rebuilt with business as to where you raise funding. Part of that is awareness and making sure you go to the right place. Our sense is that trust is improving, but if you look at the data a lot of companies are saying they do not want to borrow, so actually actively paying down debt and building up small amounts of capital. That probably does suggest that there is not enough confidence that they are either going to get accepted or that they have the confidence to invest further in their business. That is slowly rebuilding, and it is rebuilding because we can all point to examples of companies that we have backed that are succeeding. That local element is what builds trust.

The other couple of points I would make on that are, when we hear concerns about banks, you very rarely hear concerns about the local relationship manager, because that is a personal relationship. They know somebody. Over time, as we are seeing alternative sources of funding and as we are seeing companies being able to raise capital, that trust will improve.

Just picking up on one of James' points, the common complaint that we hear, and this will be true for banks and investors, is that it takes too long, which is clearly one of the great advantages of technology. We talk to many entrepreneurs about investing in their business. It is very rare that they think it is worth less than we do. They all have a very high view of what the cap value of their company is, and sometimes we may not be able to agree on a transaction, but what they are looking for is speed: "I understand what you are saying. Is it a no or a yes?" The worst thing is the lingering "no" that goes on for months. That is a common complaint, where the platforms have addressed that very quickly by the use of technology to give you a quick answer.

Luke Lang: Just quickly, I would note that challenger banks on the consumer side have had a great deal more traction. You have the likes of Revolut, which has over 1 million users, and Monzo, which took on board 500,000 users last year. They were both funded on Crowdcube, by the way. They are gaining incredible traction in the consumer market, but the B2B space for B2B challenger banks is somewhat lagging behind. There could be some work to be done there to support the likes of Tide, Atom and Metro Bank.

Q29 **Rushanara Ali:** Yes, because the last time I checked, the provisions for challenger banks are certainly not as good as they could be to encourage them. Just turning to the broader question, obviously what you do only scratches the surface. It is great, but it is less than 3%. What do you think banks should be doing to fund small businesses in the UK? Are we letting them off the hook? You have talked very positively about the role of Government and what they are doing, but is it going far enough? The evidence points to the fact that small business lending is still pretty low compared to what it was in the past.

James Meekings: That is a great question, because we are at a time now when small business lending is contracting again and has not got much airtime. In 2010, you could see net lending was negative. It got in all the papers. Since the referendum, you can see the net lending of the top 30 banks, using Bank of England data, is declining. In Q4 it was negative again. Last year, the top 30 banks added an additional £680 million into the small business ecosystem. Funding Circle on its own did

£600 million. In terms of adding additional capital, the banks are not doing it. We are here to champion small businesses. We want small businesses to succeed.

Q30 **Rushanara Ali:** What do you think we should be pushing the banks to do through this inquiry, for instance?

James Meekings: Working with us. *[Laughter.]* I knew that that would get a laugh, but it is the honest answer for me.

Rushanara Ali: The banks should be working with you.

James Meekings: I think so.

Q31 **Rushanara Ali:** Exactly how? You have touched on some of this already, but what are the additional things that you think banks should be doing to enable you, and also to increase the amount of lending that is going on to small businesses.

James Meekings: We are partnered with RBS and Santander. Banks have different strategies on this. Some banks have a strategy of, "We see all this new FinTech and are going to build all this technology ourselves". That is just not going to work in the modern era. You just cannot do everything yourself. We are not partnered with those banks.

Rushanara Ali: They are not collaborating with you on those sorts of things.

James Meekings: Some of them are not, no. They should do, and I think they will do in time.

Q32 **Rushanara Ali:** Are there any examples where there is collaboration going on?

James Meekings: With us there is the collaboration with RBS and Santander. It is working well.

Q33 **Rushanara Ali:** Is that on inventing new things, or working with what you have, or are they doing both?

James Meekings: That is working with what we have. The challenge that you will have—and this is one of the challenges with the Government's referral platform—is when a small business goes into their branch, they talk to their relationship manager about getting a loan; they do not enter a system anywhere. When you see, for example, Lloyds adverts a few years ago saying, "We approve nine out of 10 business loans", it always winds businesses up, because that does not reflect their experiences of going to a bank.

The challenge with the Government's scheme is it is really at the bottom of the process. It is not getting all those leads at the top. Our experience is you have to work very closely with a bank to work with their customers and go to their quarterly meetings, et cetera. Some banks are up for that; others are not.

Q34 **Rushanara Ali:** They used to do that quite well in the past, did they not?

James Meekings: Yes, and they should be encouraged to do that more. We have to be conscious of the fact that we have built a banking system where we do not want banks to fail. We want depositors' moneys to be guaranteed and safe, so it is right that banks have high capital requirements for different types of lending. They have to partner to service all their customers, as opposed to trying to do it themselves. There is technology. Can they build the technology? I am not so sure. Do they want to lend to small businesses? I am not so sure. Partnership is the way forward.

Stephen Welton: Can I come in perhaps with a slightly different perspective on that? There is a danger when we are looking backwards to where we came before the financial crash and how we get back there. We need to be looking forward, because the finance system and the world business is changing dramatically. It is perhaps good to look at what happens in America. In America, 80% of business funding is not funded by banks. It is funded by the capital markets. In this country, over 80% and greater of small business funding is funded by the clearing banks. That makes the system very reliant on clearing banks. Alternatives are an important move in that direction. The challenge for small businesses is that they do not have access to funding in the way that large businesses do.

Q35 **Rushanara Ali:** Banks got significant Government support to provide lending to small businesses.

Stephen Welton: I am not saying that they should not do that, but I am just saying the banking system has to work and the banks have to lend, but that is not enough. What we have to do is dramatically increase alternatives. There are good examples, as I say, in America. The capital markets are the reason the American economy has such access to finance on the best possible terms; it has the biggest pool of capital.

Q36 **Rushanara Ali:** In that classic British way, we have some really good initiatives. You talked about scale earlier, not only scalability for businesses but also scale in terms of what is being provided to encourage lending. We need to step up significantly where the finance is, whether it is in your sector or in banking, but it needs to happen in a twin-track way. That is what is missing, whereas the Americans have a very scaled attempt.

Stephen Welton: The great example of that is many British businesses are successful and then they get sold. Often, they get sold to Americans. When a business gets to a value of £50 million or £100 million, why sell it then? That requires, again, more capital, because you have to double down, as it were, to put in more capital, take more risk, to build a bigger company.

Q37 **Rushanara Ali:** I have two quick questions, one particularly for Katrin, which is about the bank referral scheme. You have touched on that earlier on, but can you say more about how banks are behaving in terms of referrals? Where are the areas of concern? Obviously there is some suggestion and evidence that they are not recognising that it is a requirement, rather than optional. What can be done to make improvements in that arena?

My second question is to everyone. It is in relation to the think-tank Civitas's recommendation that there should be a new state-backed British investment bank to plug the shortfall in lending to small and medium-sized businesses. What do you think of that proposal? Is it a simplistic solution? Is it reinventing or reimagining ideas that have come up in the past? Is that really a solution, or do you think you have the solution?

Katrin Herrling: I would like to add to Stephen's point, which I absolutely fundamentally agree with. We need to look at what should be the optimal structure of future finance, not how we go back to where we were. I agree with the sentiment of a large proportion of finance not being necessarily provided by banks. Banks may not be the best institutions to assess the risk and take on the risk on their balance sheet. The diversity there is really important.

The second point there plays into the mandatory referrals as well. It is not just about finance. It is also about advice. This is where we often ignore the role that banks have traditionally played that has fundamentally changed for the smaller end of the spectrum. The advice is no longer being provided, as we heard, with closing of branches, et cetera. It is reducing access to advice, and we are seeing a shift in the ecosystem where other players are becoming more important. Making that ecosystem with ICAEW work is really important as part of building a solid, robust network that provides access to the right types of finance.

On your question of mandatory referrals, the expectations around the referral process need to be realistic. We need to build a process, together with the banks, that works for all participants. We have found that the banks are collaborating with us. They certainly are absolutely fulfilling their obligations from what we can see, in terms of making the referral available to customers.

What we have seen is that we have needed some time to embed the process, on the banks' side, on our side, et cetera. We have seen a significant uptick now in terms of the financing solutions that are being offered, and therefore additional access to finance being provided. It is about making sure that we are all comfortable and supporting the outcomes that the referral process is creating, to ensure that people are taking up these opportunities.

Q38 **Rushanara Ali:** You do not have any concerns about it so far. It is going steadily in the right direction.

Katrin Herrling: There has just been an audit around the bank processes. I think it has come back as saying the banks are doing everything they are required to do. I know that banks are usually very good at ensuring that they are compliant with what they are required to do. I would not have any indications that they are not complying with the process.

This is about trust, actually. You asked earlier about trust. This is trust between the banks, the frontline in the bank and the referral scheme, making sure that everyone understands that we have the same objectives in mind, and we want to find the best financing solutions for customers.

Q39 **Rushanara Ali:** Are there any comments on the state-backed bank?

Stephen Welton: I can comment on that. They are talking of potentially £20 billion going into a UK investment bank. Some comparisons can be drawn with what happens in Germany with the KfW and the funding gap identified by the Patient Capital Review. We could debate long and hard what the size of the gap is. There are enough reports suggesting there is a need for more capital. Whether that should be provided by a wholly owned Government institution is a different debate. Will that actually crowd out the private sector? What is the right role for the Government? The Business Bank is clearly there. There is going to be a big gap in funding from the loss of funds from the EIF and then the EIP more generally, which is a different issue. It goes back to the answer I was giving earlier. We clearly need more capital, and a lot of different reports are identifying there is a need for more capital.

Q40 **Rushanara Ali:** Where would you put it? Where do you think it should go?

Stephen Welton: The Business Bank has a critical role. A number of my colleagues have talked about that. They are clearly going to get some of the capital. If you look at the Patient Capital Review, it is talking about the Business Bank having another £2.5 billion, providing they can get £5 billion of private sector funding. That is the key challenge, because Government can obviously contribute, but Government should not be contributing alone. The challenge is to get the scale that we need by bringing in outside investors.

Q41 **Rushanara Ali:** Does anyone else want to finish off on that? We will have to be very brief because I am getting looks from the Chair.

James Meekings: We always need to see more about how these things would play out and actually work. From what I have read so far, I do not think I would be supportive of it. I completely agree with what Stephen said. It is about backing the British Business Bank to put more money in to catalyse the private markets to grow a market with competition, choice and innovation. If we go down the route of having a state bank that all small businesses are going to go to directly, it is just not going to work.

The other thing that I have heard is that the Business Bank has not grown very quickly and we need to move it quicker. Fine, let us do that.

Let us push it quicker. We also have to recognise financial services is a huge industry. Whilst we are a small share, all of our businesses have been growing very quickly. We have to be conscious that if you grow a bank very quickly it can not work out very well. Do we want that to be a taxpayers' bank? Probably not.

Luke Lang: Just quickly, what businesses really want is choice. I think we would all agree with that on this panel. We need to make sure that whatever we do is supporting a wide range of different types and sources of finance and is having a rich, diverse range of solutions for businesses.

Q42 **John Mann:** What these businesses, SMEs, are saying quite a lot is they want to be treated fairly. They want fair redress if they have not been treated fairly. What guarantees do they have if they borrow from you?

James Meekings: It is in our DNA to be supportive of small businesses. We were set up to be fair to them. We have a slightly different model. It has strong benefits in this place, compared with a bank. We obviously operate a platform with investors on one side and businesses on the other side. We are a natural arbitrator between both of those sides.

We call our strategy, in terms of working with businesses when they are running through difficulty, "survival for revival". That is how we think about it. We want businesses to survive. We want to give them payment holidays to do that, so they can rebuild their businesses and start new ones. We take that into all of our actions working with business advisers. If a business is going through difficulty then we connect them with a business adviser. Ultimately, what we are prioritising is the survival of that business to make sure we can maximise the total recovery for our investors over a longer period.

We probably take a longer viewpoint on it than a bank would do. That is one of the downsides of banking, because it sits on their balance sheet. We have obviously seen this in the RBS news. It sits on their balance sheet, gets to the end of the financial year, and there are financial incentives on their behalf to act differently with their customers. Categorically, we will not do that, because we are a platform and a natural arbitrator between two sides. As I said at the start, it is in our DNA to treat small businesses fairly.

Q43 **John Mann:** You do not think you should be covered by any regulation.

James Meekings: No, I think we should be covered by regulation. We have always promoted regulation. To be honest, regulation for our sector has only come about because we have been pushing it. Small businesses need to be regulated in the right, proportionate ways. If you look at what happened with RBS and GRG, actually the FCA were regulating that activity. Whether it is regulation or not, it is all about fair practice and making sure that is actually happening.

Q44 **John Mann:** Do you think your SMEs that have a grievance ought to have access to the Financial Ombudsman, or to a wider tribunal beyond the Financial Ombudsman, as has been proposed?

Luke Lang: Yes, I would definitely support an initiative like that. That would be a good step forward.

James Meekings: That is almost the case today. This is where there is not a level playing field between different types of finance provider. If I explain that, what I mean is, because we are a peer-to-peer lending platform, that is our regulation. We sit within the FCA's remit. Someone who is just lending institutional, no retail, would not sit within that remit.

Currently, as we are regulated by the FCA, most of our small businesses—I think it is 95% of them—have claim to the FOS. I think the FOS includes up to 10 employees. There is some cut-off like that. If you are small enough, then you can get access to it. What is interesting is whether that should be wider. It should be wider, but we should make it wider for everyone, rather than just a sub-segment of the financial services industry. Ultimately, you will cause regulatory arbitrage and people will stop doing regulated ways if they can operate in a less controlled way somewhere else.

Q45 **John Mann:** If that happened, I think you would say that would be fairer. Would that give you an additional advantage compared to now? Are you at a disadvantage because of that?

James Meekings: I do not think our business today is at an advantage or disadvantage. We fundamentally believe in empowering small businesses. We want small businesses to survive so they come back to us and take out more loans, et cetera. We want to treat them fairly. Currently today, 95% of our customers can go to FOS. If we went to a world where actually we were doing bigger loans and they cannot go to FOS, there should be a way that they can do that.

Q46 **John Mann:** Is there any part of the regulatory regime that is an unnecessary burden for you, either in actuality or in terms of the level of bureaucracy involved?

Luke Lang: The regulation on our side is actually pretty good and balanced. We fed into the initial regulations that were introduced in 2014, and they adopted a lot of the principles and practices that we had already been running.

The one thing that I would highlight is there was a post-implementation review that was, I think, due in the middle of 2016. It is now over 18 months late. That is not particularly helpful. The FCA could have done a better job of completing that review, pushing that forward and going public with their recommendations. I personally see that as a positive. If there were some issues there then they probably would have accelerated the publication of that review. I certainly do not think that type of thing helps.

On the whole, regulation for equity crowdfunding is pretty fair and balanced. There is some tinkering around the edges that you could do. It has certainly enabled our industry to go from a very nascent industry to really flourish and become a mainstream source of capital for British entrepreneurs. We are genuinely leading the world when it comes to alternative finance. Peer-to-peer lending and equity crowdfunding is at the forefront of that. That is something we should be proud of. It pains me to say it, but we should give the FCA some credit for that.

John Mann: You do not need to be pained to say it.

Chair: We do not hear that often.

Q47 **John Mann:** Is there anything additional, Mr Welton, Ms Herrling, that you would like to add on that? You do not have to.

Stephen Welton: Not so much on regulation. When businesses get into difficulty, one of the ways to try to help that is actually through governance of the companies themselves. A lot of small businesses naturally are built up with a very small group of people advising them. We are always encouraging companies to have independent directors, because those independent directors have probably seen difficulties before. Clearly, the earlier you can identify a problem, the earlier you can try to solve it. Whether that is mentors or independent directors, encouraging businesses to bring them on board helps. It helps to deal with difficult situations and, going back to your point about transparencies, when you do get into difficult situations trying to understand what caused the problem.

In our case as an investor, not every business will succeed and obviously there will be some failures. A problem manifests itself in a requirement for capital and being long-term and patient. We have a good example, if we look back over the last couple of years in Aberdeen on the North Sea. When the oil price collapsed, most small businesses in Aberdeen were in very difficult financial circumstances, because orders just stopped overnight. Some of their big customers went bust. As an investor, the power of equity is that you stick through the tough times.

We did not lose any of our businesses through that period of time. In December of last year, our largest investment made a significant follow-on acquisition because we helped support them through that period of time. That is because it was a viable business and that sector was hit by external factors. Being able to understand the nature of the problem and then openly discussing it is how you are going to find solutions.

Q48 **John Mann:** My final question strays into another area that we are looking at. In terms of the independent directors, do you have any problems finding sufficient quality women to be effective independent directors? It was either Mr Lang or Mr Meekings who referred to the fact you were finding lots more women were coming forward and were very successful as entrepreneurs. That would suggest that is not a problem.

Stephen Welton: It is a problem of scale. We do not have as many female entrepreneurs coming to us, trying to raise capital, just as a pure mathematical thing. We have a talent network now that is like an in-house headhunting function. There are just under 5,000 people. We can actively look at the balance between experience, gender and location.

One of the things we often find with a small company, if you are bringing in a chairman, is they say, "We want someone who has been a chairman before". If someone has not been a chairman before it is a disqualification to begin with. One of the things we are doing is putting female directors on to boards, not necessarily as the chairman, so they have been on a board. Then when a chairman role comes along they have suitable qualifications. We are actively trying to do that because it adds diversity. That is not just for the sake of. It adds different senses of judgment and experience, and it helps to improve that debate at board level.

If you look at our network as a whole, it is still imbalanced. This is clearly work in progress that we need to address. Because people are talking about it, and clearly Parliament is talking about it, the interest in this area is actively changing. Public companies are actively looking at how they have more female and independent non-executive directors. That is helping, because it is setting the right background for the discussion.

Q49 **John Mann:** Mr Lang, Mr Meekings, have you a contribution to make, in terms of the failures of the finance sector to bring forward, encourage and allow women to progress?

Luke Lang: There is a huge amount to do. I touched on it earlier. In 20% of the deals on crowdfunding platforms, the money goes into female-founded businesses, but still 80% of the money is going into male-founded businesses. That 20% is twice the amount of VC or private equity money, but I really firmly believe that reflects the venture capital community, which is highly biased towards middle-aged men wearing suits, investing in other middle-aged men in suits in tech, I suspect. Sorry, Stephen.

Stephen Welton: Was it aimed at me?

Luke Lang: No, it was not aimed at you.

James Meekings: We are all wearing suits.

Luke Lang: It was not aimed at you. One in 10 decision-makers in UK venture capital firms is female, so they are outnumbered, and that needs to be redressed. Equity crowdfunding and alternative sources of finance break down some of those barriers, create a level playing field, and mean that a richer, more diverse community of entrepreneurs can access finance.

Q50 **John Mann:** Ms Herrling, do you have a comment? I am sure you do.

Chair: We had better ask Katrin.

Katrin Herrling: It is quite interesting, because the problem is a little bit deeper than just in terms of what is available. What we find—and I think James has referred to this before as well—is that women are actually much more fundable. One of the reasons women are more fundable, they have high approval rates and they achieve a higher percentage of the funding that they are seeking is because they tend to be more risk-averse. They are very concerned about the ability to repay money that they are borrowing. That makes them excellent candidates for debt finance, but it also says something about how female businesses, potentially, are built.

I do not want to go too far in extrapolating from this, but there is something inherent in women potentially having a lower risk appetite than their male counterparts. They may therefore, in some cases, not be as aggressively seeking risk capital for their companies. I consider myself quite type A, so I am probably not considering myself the risk-averse entrepreneur, but there is a fundamental difference in terms of the way women grow their companies. It is not worse, but it is a more measured and lower-risk approach. We can see that in the debt approval rates and the higher proportion of funding that we are able to give these women. Is that something that we necessarily want to change? Not necessarily. This is a personal choice that women make and that they are comfortable with. What we have to ensure is that women-led businesses that seek access to risk capital are not disadvantaged.

The overall proportion is not just driven by access. It is also driven by the types of businesses built by women versus men. Let us be clear: I believe that putting yourself, as a female, in front of a VC committee of 10 males is something that not every woman would necessarily cherish. Is that something that we are actively trying to change? Yes, in the VC community.

Luke Lang: Our data backs that up as well. As a female entrepreneur on Crowdcube, you are more likely to hit your funding target than a man, so that more measured approach that you are talking about there works. Also, on the investor side, 25% of our investors through the platform are female, so we are breaking down barriers on the investor side as well. If you look at traditional angel investing pre-Crowdcube, under 3% of business angels were female, so it is a significant improvement to have north of 25% on crowdfunding platforms.

John Mann: Thank you. That was very useful.

Chair: That is very interesting.

Q51 **Mr Jack:** Luke, this is for you. I should declare that I have invested through Crowdcube, although if I am a middle-aged man in a suit I will live to be 108, which is quite cheerful. Crowdcube is taking equity positions in businesses. What diligence are you required to do if the company produces an IM?

Luke Lang: We do not take an equity position. We are a platform—

Mr Jack: No, you facilitate it.

Luke Lang: We facilitate it.

Mr Jack: When you advertise it, how much responsibility do you put into researching their IM to make sure that the offer is genuine?

Luke Lang: We are bound by financial regulations. There are financial promotions regulations. A pitch that is created on Crowdcube needs to be fair, clear and not misleading. We will go through every statement of fact, we will check it and see the verification notes from the entrepreneur and check those documents. We will also look into the background of the entrepreneurs and the people behind the businesses, and do credit checks and director checks to find out more about those businesses.

Q52 **Mr Jack:** If they do not declare asset finance or something like that, how would you react?

Luke Lang: We ask them to declare what finance or funding history they have had and whether they have any outstanding debts. We would see that and be able to check that. We actually have a due diligence charter that we publish on every pitch that goes live on Crowdcube. That outlines exactly what we do check and what we do not check and the due diligence we do for every business. We were market leader in that, because we felt that we needed to be more transparent with our investors with what we are doing.

Q53 **Mr Jack:** Is the pre-money valuation set by you or by them?

Luke Lang: It is set by the company, although we do interject if we feel that it is a little bit too ambitious. We have lots of data. We have been going now for over seven years, so we have lots of data on what valuations work and what do not. We know that if valuation is a hot topic in a forum then your chances of success are going to diminish, so it is in the interests of the business to have a fair valuation and get the investment that they need. That is the message that we tell entrepreneurs.

Q54 **Mr Jack:** If, post raising the funding and closing the book, you found that the IM had been inaccurate, what would you do?

Luke Lang: We would conduct a review. We would investigate it, try to understand where the failings were, and look to make improvements and rectify for the future.

Q55 **Mr Jack:** What about to the investors who might lose their money on the back of that?

Luke Lang: To my knowledge, that has not happened. They would have redress through FOS. They could go down that route.

Q56 **Mr Jack:** Is there any penalty that you might suffer?

Luke Lang: Yes, certainly through the Financial Conduct Authority. There are heavy penalties for any inaccurate financial promotion. We are a regulated firm and we take that seriously.

Q57 **Wes Streeting:** We have touched on this already, but I want to ask about data, particularly the innovative use of data, and whether the regulatory framework is right. Can I just ask a broad question, just to elicit views across the panel to begin with? How important is the innovative use of data in allowing non-bank providers of SME finance to accurately assess creditworthiness? Where relevant, could you explain some of the innovative sources of data that you use when making underwriting decisions, for example?

James Meekings: Data is incredibly important to what we do. We do not let investors lend to start-ups through our platforms. Everyone has to have at least two years of track record. On average, businesses have 10 years. The purpose of that is so there is more of a data footprint so we can understand that business better. I should say that every loan that goes through Funding Circle's platform also has—it sounds strange to say—a human underwriter who looks at it. We use the data to decide what level of seniority underwriter should look at that. The data enhances our credit risk process.

That is what allows us to do what we do online. At the moment we will pull in data from credit bureaus, so the business does not have to get that data. It makes it much easier. We pull the directors' reports, so the business report and the consumer report. We will also get information that we request from them through the application journey, so financials and bank statements. We take those bank statements and run them through digital technology, so we can run algorithms on those as well. The purpose of running all that data is to do two things. One is to say, "Should a human spend time underwriting this or not?" The other is just to say no, to make it quicker for the business, which is better for them.

The other thing is to price the loan. We use all the data to set an interest rate based on the risk profile of that business. In the UK we have now done 30,000 loans. We have thousands of data points on each individual business, so we are a data-led business on that front. That is what is allowing us to expand capital to more and more small businesses.

I am probably going to disappoint you a little bit on your second question. That was what innovative sources of data we are using. As much as banks would like to say, "There are these new platforms using Facebook data, et cetera, to underwrite loans and it will not work", we do not do that. We have done all the work. We find the value of adding on those sources is incremental, but it is not as much as your data that comes through credit bureaus. That industry has existed for decades, so it is no surprise that data is valuable.

When you add bank data on top of that it makes a material difference to your understanding of credit risk. That is something that we have been doing through getting paper copies of bank statements, converting them into digital copies, getting other people to type in stuff, because you cannot convert everything, and getting the value out that way. When open banking fully comes into play, and people adopt it as well, because there are two different stages to it, that wealth of data will mean that we can say "yes" to more businesses. It means we can price the businesses more accurately. It means we can monitor their performance and support them through their journey even more.

Data underpins everything that we do. It is like I said at the beginning: we want to create a platform where businesses come back to us again and again. We want to use data to understand that business, so we can go to them and offer them finance at the right time, whenever they need it.

Q58 **Wes Streeting:** How satisfied are you with the progress being made on open banking?

James Meekings: That is a good question. It is a huge thing, so the fact that it is happening is incredible. It is going to take time to get there. The media and stakeholders all need to have faith. It is going to be a journey, not only in terms of getting the banks to put all the data in, but for customer adoption in getting there. There are some challenges to overcome there.

It is an interesting thing for small businesses. You would have to check this, but I think open banking goes up to £6 million. If you are a £7 million turnover business, then the bank does not have to give your data over to alternative finance providers. I see that as a stage 2 thing. We need to make sure there is more data available from banking available to other funders all over the place. Katrin will have a view on this. It will really make a comparison between different finance providers a lot easier.

Katrin Herrling: I would love to add to this. We are, in a sense, a data analytics business. What we do is essentially use the same sources of data that all our lenders are using to shadow underwrite loans, to be able to tell you who is going to fund you and on what terms. We are using sources of data from open banking. We are an AISP. We are in the process of building. We are allowed to access open banking details as of 13 January.

We are also using CCDS data, so we are working with credit reference agencies. The benefit of the CCDS data is it is commercial credit data. It is aggregated at the account level, but the benefit is it is available for any customer who comes to us. We will be able to draw on it at the same time as we are getting access to credit scores. It therefore gives us a good sense of the affordability of different loans. Affordability is really what is at the heart of what we need to understand about the business, to be able to understand what type of financing solutions may be available.

Yes, we are using data. The data is transformative, not just in terms of helping us see who is likely to fund you instantly—and businesses want that instant answer—but it is also a really important way of reducing the cost of access to funding. What we are trying to do, and where we are working with our lenders, is to reduce the amount of work that is required to credit-assess 100 companies to find the five companies that a lender can fund. By being able to do that assessment up front, we are actually reducing the work that lenders have to do when we are introducing a customer to them, so that they can fund 80%, 90% or 95% of the companies we introduce.

This is transformative for lenders, in terms of the costs that they have to invest in actually manually underwriting customers. It is about transparency and it is about customer service and instant answers, but it is much more broadly about transforming the cost of providing loans to SMEs. This is what we are already seeing. Those lenders who are most automated are actually able, because of their cost to serve, to finance requests that are marginal. Their lower cost to operate would allow them to finance small-value, more marginal requests. That is really increasing the availability of finance.

Yes, data is at the heart of making access to finance more transparent, more convenient and having broader access. The one thing I would say is CCDS is delivered in a very traditional way, where the CRAs are controlling the data. They are currently only making CCDS data available to a closed group of lenders—that is, lenders who are feeding back into the CRA system. In my mind, that is sub-optimal.

The power of this data is absolutely there. Making it more broadly available and not just to a closed group of lenders should stimulate innovation, reducing the cost of funding for more SMEs. Actually looking at the availability of CCDS data in the short and medium term is going to have, in my mind, a bigger impact than open banking. I agree with James that open banking is going to take a little while to bear full fruit. It is a massive effort. It is going to have an impact, but it will take time.

Q59 **Wes Streeting:** There have been some complaints about the delay on CCDS as well. I just wonder how harmful you think that slow progress has been.

Katrin Herrling: It is hard to judge how harmful it is. It has delayed the ability to incorporate this and make more accurate, transparent recommendations to businesses. Making this data available now is fantastic, but yes, of course we would love to have access to data sooner.

The other effort that you are driving, which will actually have a surprising impact on access to finance is Making Tax Digital. Avoiding delays there is going to be very helpful, given that Making Tax Digital is actually giving us a point in time every quarter where we understand that management accounts are reasonably up to date. They are not 100%, but it is giving us a very good additional data point to understand management accounts and performance of the business. All of these efforts that are being driven around making data accessible and cleaner, I want to say, are going to be helpful. I would plead with the Government to ensure that Making Tax Digital is implemented as swiftly as possible.

Stephen Welton: From a completely different perspective, because we are actually an investor with our own balance sheet, not a platform, we obviously welcome anybody coming to us, but are keen to go and find these companies. We want more of them to scale up. Working with a scale-up institute, there is a lot of data trying to profile companies that are growing at 10% a year over a three-year period, which would meet those criteria. There is a lot more information available now. When we talk of 30,000-odd companies, we can identify them. Identifying them and seeing what their characteristics are means that we can actually approach them.

I would absolutely echo the comments of the rest of the panel. Data is going to enable us to all do our jobs more effectively. It will make the cost of finance cheaper and the access to finance more transparent.

Luke Lang: I would just add to Stephen's point that where we are using data most effectively is solving that educational and awareness challenge that alternative finance is suffering from. Rather than doing broad-brush Tube campaigns based down in London, we are being a lot more focused and targeted. We are actually able to identify the businesses and target them in a more sophisticated fashion. I agree with Stephen that the use of data is underpinning all the businesses along this panel.

Q60 **Wes Streeting:** Throughout much of the evidence you have given in the session, you have advocated not just for your companies and the type of work you do but for SMEs generally. That passion for SMEs has come through. From an SME's perspective, do you think there are any downsides or anxieties to allowing lenders to make use of non-traditional data to assess creditworthiness? It is probably a question for them, but I am interested.

Katrin Herrling: Maybe I can provide a little bit of insight. We believe that the implementation of the GDPR requirements that are now coming in May is embedding access to data in a very sensible way. It instils the principle that businesses or individuals should have ownership of their data and be able to control access to that data. We need to almost see these two developments in parallel. Open access to data is becoming more important and providing significant benefits. At the same time, the way data is being managed, and the way businesses and individuals control access to data, is becoming increasingly important.

I am very excited about these two parallel initiatives creating tension. We need this tension. I think what we will see in the future is for businesses to trust with the sharing of data, having that level of control. GDPR is clear. I need to be able to see what I share and delete that. That is building trust in actually putting forward data. Yes, I think if you log in and try the open banking functionality, it is a different dimension of how data gets shared. Having this embedded in very solid data management and data ownership procedures is absolutely critical.

Q61 **Wes Streeting:** In the way you did with my questions on CCDS, you have anticipated where I was going with my final question, which is around GDPR. Obviously, the Data Protection Bill is going through Parliament and cleared its Second Reading yesterday. A significant proportion of the EU's tech industry is located in the UK. The majority of tech companies in the UK rely on data transfer with other EU countries. I just wondered how much of that data dimension of the Brexit debate is on your radar as companies. Are there particular anxieties that you want to report to Parliament now, as we are scrutinising that Bill in detail and this Committee is doing particular work around Brexit? I know Catherine is going to come in with some further questions on Brexit. It has to happen at some point in every Committee meeting. On data specifically, I just wondered about the extent to which the debates we are having around Brexit and data are on your risk radar.

James Meekings: I would have to check with the team who were specifically working on that and come back.

Chair: That is something you want to write to us.

Wes Streeting: That would be really interesting for us.

James Meekings: That would be a good one to respond to in writing.

Chair: It is like phone a friend, is it not?

Q62 **Catherine McKinnell:** I was just going to come in with, "Last but not least, Brexit: discuss". No, I have some specific questions. I thought maybe, Stephen, you might like to comment, because I know you have commented publicly on the European Investment Fund, and some of the potential impacts in terms of Brexit. That includes the impact that we have already seen, but also into the future. I do not know if you have something to say.

Stephen Welton: Clearly, the funding from the European Investment Bank, and in particular the European Investment Fund, is real money going into the broader ecosystem, so it has to be replaced. If it is not replaced it will make what is already a small industry smaller. That is a significant issue and it is obviously wrapped up in a much broader discussion. The Government have said that the Business Bank has clearly got a role to play there. It would seem to be the natural party to play a role, given that it is, effectively, coming from the state.

Q63 **Chair:** How much is it?

Stephen Welton: £400 million to £700 million.

Chair: A year?

Stephen Welton: Yes, so this is a significant gap. That is outside of infrastructure that the European Investment Bank provides, which is several billion. If you look at how that is then invested, it is going into a range of smaller venture funds. It is often part of the cornerstone of those venture funds. If you take away the cornerstone, there is not going to be a fund. A number of smaller venture managers are concerned about the loss of funding. If they lose funding, it will have a broader impact on the ecosystem, which leads back to what we have talked about before. That is just another example where we do not have enough capital. In this case, the capital is there and is going to potentially be withdrawn, so we need to, as a minimum, sustain that. More proactively, how do we increase it?

Going back to the broader question of what the impact of Brexit has been so far, we are not close enough or wise enough to understand what Brexit actually means, so we have to focus on what is happening to the companies that we are backing. The clear message we sent out was, "We are very much open for business. Of course we are going to ask, 'What will Brexit do to your business?' but we are not going to get an answer, because you do not know and neither do we".

The six months post the referendum were our most active investment period ever. That just shows that we are trying to be on the front foot. What we have seen last year was continuing demand. As we get closer, as we are now 12 months away, the uncertainty factor is clearly rising. Our concern would be, if the uncertainty continues, you get to the inevitable conclusion, which is you wait. What we are trying to do, where we can have an influence, is to make sure that every company approaching us does not need to wait. If you have a good opportunity, we can fund that.

Many small businesses have much bigger issues to worry about than what is happening in the world of Brexit. They may worry about hiring staff and if they can raise capital and bank finance. To date, it has not had a dramatic impact, but it is clearly going to change the way in which British companies, especially exporters, deal with the European Union and beyond. I am sure all businesses will say certainty is something they need. It does not matter what the rules are; you just need to know what they are and you can plan accordingly.

Catherine McKinnell: That is a fairly consistent message.

James Meekings: If I could just jump in, we have seen the same. If I think back to the referendum vote, we had two very quiet months for us just after that. Business owners were just taking stock of what the situation was. Then in Q4 2016 we saw huge growth. A period of uncertainty definitely hampers business confidence. There is a question about what we can do there, as Government, to try to give more certainty to these businesses. I think I said this earlier, but just to reiterate: when you look at bank lending figures since the referendum vote, they are going down.

Banks are more hit by Brexit than we are, because they are obviously operating more across borders and passporting regulation, whereas we have to conform to different regulation in different jurisdictions. We are in the Netherlands and Germany but there is not pan-European regulation, so we are not as hindered by it. What you have actually seen over the last 12 months is some banks retracting from the space. The overall amount of additional money going in to help small businesses—so net lending—is negative again, so we are back to 2008, 2009 and 2010. Alternatives are playing a much bigger part in that.

We went to speak to the British Business Bank just after the vote and said, "What can you do to help support businesses in this time? Can you increase the amount of lending?" That was in the context that we had had the European Investment Bank, who committed to lend £100 million through our platform. It was going to become a multibillion-pound programme. I hope it still is, but, if I am honest with everyone, it is probably quite a weak hope. The team who we worked with over four years to get that deal in place have all now left the EIB. It is a shame.

For the British Business Bank, it is still tied under state aid rules. The worst scenario for British business is we do not get access to the EIB and the BBB is restrained in what it can do because of European state aid rules. The German state bank, KfW, because it was around from previous—

Catherine McKinnell: Before.

James Meekings: Yes, you guys know. They do not have this same issue. There is an ask, which is, first, about what we do with the EIB. Can we keep access? That would be the easiest thing. If we cannot, how do we release the BBB from its state aid rules, so it can actually lend more. If that is not part of our negotiation and we end up without the EIB with no state aid release, it is not going to be pretty.

Luke Lang: I would just add for the panel, not to sound like a broken record, we experienced the same thing. There was actually an uptick. The second half of 2016 was a lot stronger than the run-up to Brexit. We have heard a lot about the EIF showing signs of slowing activity. Actually, we have had better engagement from the EIF than from the British Business Bank, which is probably a poorer reflection of the British Business Bank than it is the EIF.

The one thing that I would urge is, if we are not going to have access to the EIF, we should see this as an opportunity. Maybe there is an opportunity for us to re-evaluate and reassess what we do and how we do things. To James's point, we can make sure it is not all about just lending and debt finance. There should be a wide, broad, diverse range of financial products that satisfy all businesses. That would be my ask to the Committee: to see this as an opportunity to change things for the better and serve the wide range of British businesses here in the UK.

Q64 **Catherine McKinnell:** In the context of changes, do you have a view on the outcome of the Patient Capital Review and the announcements made by the Treasury? Is that positively received? Is there more that you would like to hear the Government say they are going to do?

Stephen Welton: I sat on the advisory panel for that. The work that was done was very extensive, which is helpful. There was a detailed review, rather than a sort of anecdotal assessment. It identified that there is a significant gap. The proposal the Government have put forward to inject £2.5 billion into a new vehicle is a good start. It does need £5 billion from the private sector. I do not think that is at all automatic. If we can raise the additional capital and then invest it and support the ecosystem wisely, that will be a very good addition to what we currently have. We would absolutely support what they are trying to do, but not underestimate the challenge of making it a success.

Q65 **Catherine McKinnell:** What do we need to do to meet that challenge?

Luke Lang: It is heavily biased towards the venture capital community. As I said earlier, it is £400 million in 2016 and another £400 million committed earlier this year. I do not think that reflects the reality of what is going on. The BBB could do a lot more to stimulate and work with alternative finance providers. I recognise that there is a funding gap at the scale-up level, but I think a lot of venture capital money is being skewed as businesses are staying private for a lot longer. There is a failing of public markets.

Those businesses are staying private a lot longer, taking much bigger cheques. That is drawing a lot of investment from those funds, which is actually leaving a funding gap at the series A, post-seed round, £1 million-plus raise. We have seen huge growth in that area, where our average raise size is approaching £800,000. We funded more £1 million-plus equity deals last year than any other funder in the UK, but there still needs to be a lot more done there to support that funding.

Q66 **Catherine McKinnell:** What, for example? Obviously we have the seed investment scheme tax relief. Presumably that is welcome. Is there more that you would want? Other tax reliefs might be helpful.

Luke Lang: The SEIS and EIS are brilliant. We are the envy of Europe with some of those tax incentives. The Government deserve a lot of credit for that. They are passive though. The Government could be a little bit more progressive with their interventions. As I have mentioned before, I think there is an opportunity to co-invest alongside the British public through crowdfunding platforms, in the same way that you would match-fund through Funding Circle. We have heard what a catalyst that was for Funding Circle, and it could be the same for equity as well.

Q67 **Catherine McKinnell:** Final comments now. Is there anything else the panel want to add, in terms of what the Government can do to improve investment growth in the current Brexit and post-Brexit climate?

Katrin Herrling: I think we all agree that the SEIS and EIS are very powerful. Currently, they are not available to entrepreneurs. I understand the risk for misuse of entrepreneurial relief in this context. At the same time, I recognise that a lot of funding in the early stages is provided by the start-up entrepreneur. Thinking about having outside investors and tax-incentivising them is great. Also bringing in the founders and employees to help fund the company and providing incentives there may actually be something that at the early stages, prior to institutional investors coming in, may make a lot of sense. Right now, they are disadvantaged against external investors. It sometimes feels a bit—

Catherine McKinnell: Unlevel.

Katrin Herrling: Yes.

Stephen Welton: One thing I would go back to is a couple of years ago, when George Osborne was the Chancellor; there was a look at local authority pension funds and the move towards creating six wealth funds. This goes back to the consolidation. We have too many small, fragmented local authority pension funds. There were the first attempts to consolidate the back offices of those pension funds to drive down costs, increase efficiency, and ultimately increase returns to members.

I am not aware of quite where that has got to, but the principle of consolidating to build scale in the pension fund industry will undoubtedly be beneficial. If that is part of your review, or not part of your review, it is an integral part of funding for small companies.

Chair: That is exactly what this review is all about—the opportunities available to SME financing. Luke or James, is there anything else you wanted to add to Catherine's last question?

James Meekings: No. The state aid rules and the Business Bank is where I would focus.

Chair: I wanted to thank you very much indeed for your evidence this morning. If there are any further thoughts that you have after you have left today, please feel free to share them. Particularly, I think you are going to write about data, if that is particularly relevant to your businesses. I think somebody mentioned about asset-based financing not being represented this morning. I do not know if there are other parts of SME financing that you see or you think we should be hearing from. Again, please let us know or encourage others to come forward to give evidence.

This has been a longer session than we had expected, but that is because you have given such fascinating evidence this morning. I just hope that we are not quite as terrifying as a 10-person VC committee, which I think is what you described, Katrin, as the ultimate in terror for some new entrepreneurs. Thank you very much indeed for your generosity of time this morning. It is much appreciated.