HOUSE OF LORDS

# Select Committee on Economic Affairs

## Corrected oral evidence: Employment and Covid-19

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3 pm

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Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Lord Burns; Viscount Chandos; Lord Fox; Baroness Kingsmill; Lord Livingston of Parkhead; Lord Monks; Lord Skidelsky; Lord Stern of Brentford; Lord Tugendhat.

Evidence Session No. 5 Virtual Proceeding Questions 37 - 44

### Witnesses

I: Claire Walker, Co-Executive Director, British Chamber of Commerce; Rebecca Lowe, Research Director, Business Growth Fund; Marcus Scott, Chief Operating Officer, TheCityUK.

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# Examination of witnesses

Claire Walker, Rebecca Lowe and Marcus Scott.

Q37 **The Chair:** Welcome to the Economic Affairs Committee, Rebecca Lowe and Claire Walker. I think Marcus Scott is going to join us at 3.30 pm. It is good to have you here to help us with our inquiry on employment and Covid-19.

Perhaps I may begin by asking the first question. Which of the loan schemes have been most effective, and why? How large is the risk of wide-scale business defaults and insolvency? In asking that question, I should declare an interest as chairman of the Secure Trust Bank.

***Claire Walker:*** First, thank you for inviting me to speak to you. I am co-executive director of the British Chamber of Commerce. As many of you will know, we have 53 chambers up and down the UK and 63 international chambers across the world.

This has been a really difficult time for business communities, as I am sure you are all aware. They have faced the challenge of a generation in addressing some of the big issues that the pandemic has presented to them.

To give you a bit of context, throughout the pandemic, the BCC has run a business tracker—

**The Chair:** I am sorry to interrupt you, but you can assume that all members of the Committee will have read the evidence and been briefed on the background. We have only a short amount of time, so I would really like you to focus on the question.

***Claire Walker:*** As regards the most successful loans, we have seen a lot more success with the BBLS loans than with the CBILS loans. That is partly because of the fact that that scheme was underwritten in such a substantial way by the Government. Anecdotally, many of our members have struggled to get access to CBILS loans.

Critically, though, one thing that has been a worry to some of our members is, depending on their bank, they may or may not have been able to access the loans because new lenders were not being taken on, or it was a slow process, and some of them may have banked with other banks that were not able to allow new entrants. That has been a problem for us.

We are concerned about the debt being built up during the pandemic. Recently we did a survey with TSB: 64% of respondents said they were worried about refinancing the financing bill they have built up during the pandemic. Many of them will have spent that money on paying salaries and core costs, and keeping the business going throughout that time. In particular, about a quarter—27%—are worried that by repaying this very quickly they may have to scale down operations, or potentially even have to shut up shop, which is a very worrying trend given that the economy is very delicate at the moment.

**The Chair:** Is it possible to say which sectors are most vulnerable?

***Claire Walker:*** We know that micro businesses are the most vulnerable. We know that about 15% of them have suggested they would have to shut up shop if they had to repay very quickly. We also know that, broadly, manufacturing sectors tended to take out more of the loans than other sectors, although our evidence suggests that is across the piece. We are seeing quite a big range across the piece.

**The Chair:** Rebecca Lowe, what is your take on the situation?

***Rebecca Lowe:*** Thank you so much for inviting BGF. As research director, I have been thinking about the Covid crisis from a general policy standpoint, but I spoke with our investment team ahead of the session so I could report back to you with some direct reference to its feedback.

As for the kind of investor we are, we are interested in the growth economy, which we define technically as companies reporting turnover of between £2.5 million and £100 million. That has limited our engagement with the schemes, particularly the Bounce Back Loan Scheme. Owing to the size of the companies we work with, we have had limited exposure to that. Similarly, we have no direct experience of the Bank of England's CCFF.

Many of our portfolio companies have engaged with CBILS and CLBILS. Although this is a minority of our portfolio as a whole, understandably, because we are focused on capitalising companies for growth, the general view that I heard was that the schemes were launched commendably quickly, and availability has been good, although, as already noted, quite often limited to a company's existing lender. It has been difficult to engage lenders in marginal cases from a traditional credit assessment perspective. There is concern about the impact of increased debt on companies' growth aspirations, and about what happens in the spring when interest starts to be paid, and the knock-on effect with other cash requirements and banking facilities.

As for our direct involvement, I should note that many BGF portfolio companies reinvest trading profits into future growth initiatives, as you would probably expect to be necessary for growth and innovation, and about 25% of our portfolio companies were ineligible for either of the two schemes that we engaged with owing to historic losses.

This reflects how the CBILS scheme is not as suitable for emerging companies, because they will not be seen as fitting normal lending criteria.

However, where our businesses could demonstrate historic profitability, we saw good support. About 70% of the portfolio companies—of the minority that applied—were able to raise capital. There is a mixed experience regarding the speed of loan approval and provision, but, generally, I would say from having spoken to the investment team that the view is that the lower-volume CLBILS scheme has been less successful than CBILS, owing to the larger scheme's requirements on security, and requirements to rank alongside more complex and material senior debt providers.

I would finish by saying that the two main concerns that stand out to me are the point about indebtedness—I could talk a lot about general indebtedness, not just Covid-acquired indebtedness but existing indebtedness—and the way in which the focus on debt has meant that equity has been overlooked. Long-term solutions are needed to underpin recovery and future growth. I could go on in more detail about future concerns if you like, but perhaps that suffices.

**The Chair:** Thank you very much.

Q38 **Baroness Bowles of Berkhamsted:** I suppose I had better start by declaring my interests as in the register, in particular as an adviser to Valloop, a fintech investment fund for SMEs.

What trade-offs or risks arise from deferring Covid-19 loan repayments until a business is on a secure footing?

***Claire Walker:*** We surveyed our members. Some 16% wanted to see a loan repayment delay. Some of them would like a student loan-type scheme.

There are two things to bear in mind. The first is that there is a triple whammy coming for businesses. They have the potential of further lockdown restrictions. They have the ending of the national schemes such as furlough. They have a transition period at the end of the year, which is a change in business circumstances. We know that their cash flow is low. We know that most firms have about one to three months' cash flow available. There is a real risk there.

The risk on repayment is that, if we do not look at some ways of perhaps stretching the term from six to eight years, or delaying the start of the interest payment, we could see many of them default. It is a real benefit for us to delay and look at the options in ensuring that they can repay the loans over a longer period or more slowly. Businesses will have to start paying interest from 1 April. We may not be out of the pandemic then and, equally, businesses will have just had a very difficult winter.

There is a real sense that this needs to be looked at again. We are submitting this in our submissions for the Budget and the comprehensive spending review. The risk potentially is that, if we go too quickly on repayment, firms will stifle their growth and stifle their—*[Inaudible.]*—and potentially not be able to continue to operate.

***Rebecca Lowe:*** I should note that BGF has not formally proposed such an approach, but we are interested in it, and various elegant versions have been proposed. In weighing up this trade-off, the main benefit would of course be to allow otherwise more promising companies more time to recover and be able to pay back what they can when they can.

It is proposed by proponents as an alternative to cataclysmic mass insolvency, job loss and devastation of the SME backbone of the economy.

A vast amount of debt is currently deemed unsustainable, much of it owed by SMEs. TheCityUK has done very good work on estimating that. If the state-backed Covid debt could be converted into something more long term, as Claire has mentioned, otherwise healthy companies could begin to recover. There would be increased certainty, and confidence would increase. Cash would become available for investment opportunities and there would be the potential for growth and debt amortisation becoming a variable rather than a fixed cost.

The main risk, however, of a contingent approach is uncertainty on all fronts. Beyond the general stress that ongoing unpaid debt can cause to borrowers, this kind of uncertainty, while it may be better than to have to pay back immediately at all costs—which may not be possible—is not generally conducive to growth.

For the lender, who of course we should not forget is the taxpayer, there is also a serious risk in this kind of uncertainty, not least as the payback becomes performance dependent rather than a fixed cost. Borrowers with an uncertain outlook on what their debt repayment obligations will be in the future may choose to curtail growth.

Further risks include the possibility that some companies will try to game the system, although the good proposals I have looked at, such as TheCityUK one, try to introduce some mitigants against that.

Of course, as after the GFC, there is also a serious risk of a swathe of zombie companies. That said, of course, there are also massive risks and taxpayer costs in just letting promising companies default and collapse, not least because it is the taxpayer who has been investing and giving the debt to these companies over the past few months, and because of the present and future costs.

In conclusion, I would say that any deferrals should be set in the much broader context of ensuring that companies are properly capitalised—I am sorry to repeat my point about equity yet again—and not just a focus on debt, so that they are able to weather not just the short-term challenges of debt they have taken on but be able to grow long term. There is a real obsession with short-term debt and guarantees, and that is not really a solution. It is more a knee-jerk reaction. Long-term thinking and a focus on proper growth capitalisation is what is required here.

**Baroness Bowles of Berkhamsted:** You are thinking about the long term and equity, which feeds into my follow-up question: how can you prevent the proliferation of so-called zombie companies if financial support is continually extended? I suppose there is also the issue that a lot of tax deferral is going to fall due at the same time as interest payments, so there is a lot going on.

***Rebecca Lowe:*** This is a very good point. It is not just the Covid-acquired debt. There are the HMRC deferrals, stretched creditors, et cetera. Balance sheet stress goes beyond the government support, does it not? The risk of zombie companies could be devastating, as we saw after the GFC. As I said, these are companies that are just strong enough to survive and pay interest—and in due course some principal—but not strong enough to grow. Again, there should be a real focus on recapitalisation. The focus so far, particularly at the beginning, understandably, was pretty broad brush, but a broad-brush approach without any kind of discrimination over which companies have the potential for growth can be really devastating.

***Claire Walker:*** I think the only other thing I would add is one of the things that has been really unique about—

**The Chair:** Hang on one second. I think Baroness Bowles wanted to come back on that point.

**Baroness Bowles of Berkhamsted:** You want to discriminate in favour of companies that offer growth, which I agree in a zombie scenario is what we are talking about. Should they be favoured over and above those that perhaps are more deserving because the Government actions have closed them down more?

***Rebecca Lowe:*** I have been thinking about this a little bit. I do not want to get too philosophical, but I think these notions of desert are sometimes a little complicated when we are thinking about economic matters. We might want to think more about being aware that taxpayers' money should be invested prudentially—looking to assess where a return is going to be possible. Notions of desert are wider, and that is complicated at the moment when we are thinking about national and local interests.

A commercial business-based approach has strong traditional credibility in a situation such as this. There needs to be some level of discrimination. I would certainly argue that a commercial approach to assessment is more successful. You want to have local investors on the ground, who know what is going on, so I would certainly advocate a decentralised professional commercial-based approach.

***Claire Walker:*** A slight counterpoint is that one of the remarkable aspects of this pandemic is that previously viable businesses, which would have been really quite promising as regards investment, have seen themselves being restrained, mainly because of government restrictions. We need to be careful that we do not necessarily go too far along that route and ensure that we do not write off businesses that will rebound and have a future—and potentially very quickly if a vaccine is found.

It is a real balance. One thing that concerns us is that we have heard already some loans being refused to companies that are perfectly viable but that have already taken government support. It is a really mixed picture and that is why you need those specialist investors, as Rebecca says.

Q39 **Lord Burns:** I have a question for Rebecca Lowe. Your organisation has proposed a £15 billion fund to help businesses that are going to struggle to repay state-guaranteed loans. Your chief executive has said that the mounting debt is unsustainable and that new equity is going to be needed to buy out some of the debt where people could not repay it. Will you take us a bit more through how this would work in practice—what the similarities are with some of the other proposals, whether this would be specific to sectors and what issues of conditionality there might be?

***Rebecca Lowe:*** A few points of clarity. The first is, as I mentioned, we are interested in the growth economy and innovative businesses. We have been doing some research lately on what after the First World War was deemed the Macmillan gap. This is a long-standing persistent issue of access to equity for small and medium-sized companies.

What we are proposing is not exactly a specific solution for companies that are not able to pay back debt specifically acquired owing to Covid. Our point is broader: that this is a persistent issue about access to equity. We would argue that it is a serious market failure, caused by many issues, and a lack of awareness and a lack of sufficient funding provision.

There is evidence, as we have seen throughout the 20th century, that this is exacerbated in times of crisis such as the current Covid crisis. We think an opportunity arises now to address this in a larger sense than specific companies that are struggling owing to particular situations arising from Covid.

We are going to publish the final details of this proposal in a paper in the coming weeks, which we will share with you as soon as we can. May I set out its outline to clarify any misunderstandings and share our very latest thinking?

First, I should note that while, as I will explain, we think there is a role for the state, we are proposing a private sector-led initiative. The aim, as I say, is to address the equity funding gap faced by growth economy companies—a very specific set of exciting innovative businesses, of which we have a lot of experience as the largest investor in the world in this type of company.

We believe it is very much the job of private actors to drive capital where it needs to go, but we contend that the state has an important role to play in convening, liberalising regulation, incentivising and, potentially, co-investing where appropriate.

Most importantly, as I vaguely intimated in my answer to the previous question, the fund should be local, patient and commercial as regards deployment. It should be disbursed across the country by a regional network of investment specialists. It cannot in any sense represent a bailout for the City of London. It cannot be a handout in any sense, or an emergency measure focused on protecting employment. Of course, there is a massive space for those kinds of measures, but this is a separate approach very much addressing the equity funding gap.

Of course, that will have a vast employment benefit to the country beyond those companies that will receive necessary capitalisation to be able to grow. The growth economy is a massive employer right across the nation. It is very interesting, if you look into some of the work we have been doing, and the work of many others, including the ScaleUp Institute, how this is distributed right across the nation. It is very important to note that in relation to both local growth and local employment.

The contributors and the investments will be allocated and determined solely on commercial terms. In the long term, however, as I say, this will protect jobs by ensuring that the economy remains strong, flexible and vibrant.

I will get on to the more specific state involvement in a second, but on private capital we have various ideas for unlocking existing sources. One notable point about our proposal is that we want to use both existing mechanisms and sources of capital. There is a role for the state in that, not least in convening power, and, as I mentioned a second ago, in liberalising regulation where appropriate.

Clearly, there are various solutions, but we have set out to meet what we believe on our latest calculations show to be about a £15 billion gap — to meet that need and demand. We think a fund could be made up of capital from the following sources. Some of it could be invested through a quoted vehicle or quoted vehicles to channel individual investors' money through the stock market to the growth economy. There could be some investment from the DB pension schemes run by the UK's largest companies and added to that some investment from the DC pension schemes, which the Government in various instantiations has been promising for a long time, but it has not happened. We have certainly voiced our views to various consultations, but the general consensus across the ecosystem, I would contend, is that this will not happen until some changes are made to the charge cap. I can go into some more detail on that. This could unlock a vast amount of capital for the growth economy. Add to that, money from large private sector investors, the insurance industry, sovereign wealth funds and other actors.

Finally, as regards a role for the state, aside from liberalising regulation and convening some of these sources, we would argue there could be some extension of the future fund, if we were to see that as some kind of down payment. The general argument is that state involvement is probably required for a quantum as big as £15 billion, but I would stress, however, that our focus is very much on this being a private sector-led initiative, and the main role for the state would be using its considerable convening power to help.

**Lord Burns:** Given the complexity of what you are describing, how quickly could it be established? Is this really a proposal to deal with the present emergency? It sounds more like a proposal for the longer term for a problem that you think has existed and will continue to exist.

***Rebecca Lowe:*** I think that is an excellent question. I would say two things. The first is we will not solve this short-term problem sufficiently well unless we look to the long term. Short-term approaches are sticking plasters not panaceas.

I would say that part of our proposal is very much based on expanding and scaling existing initiatives. BGF is decentralised across the country. If you could scale up something along those lines, that might help. Many other players would need to be involved, too. It is very much a proposal that brings together existing sources of capital, with some small tweaks. There is, perhaps, some smart regulation required to unlock some of those sources, but nothing out of the way that has not already been thought of.

Any proper, genuinely thought-through long-term solution will of course involve its complexities, but my view is that this is a doable and sustainable approach that will not only address the short-term need but help to put us on the front foot in leapfrogging to a more sustainable and growth-focused future.

**Lord Livingston of Parkhead:** How different is this proposal from ICFC as was and what became 3i? It sounds quite similar. I am not saying that is a bad thing, but it sounds remarkably similar because that was also set up to meet the Macmillan gap.

***Rebecca Lowe:*** That is a great question. I could talk about this all day. I have been reading so many interesting papers.

**Lord Livingston of Parkhead:** That is the quick answer I had in mind.

***Rebecca Lowe:*** The interesting thing is that BGF is also based on ICFC. It is slightly different in that it is more commercial and, again, I could go into details about that.

The ICFC, which, as you say, was set up to address this exact specific problem, had its successes. It changed and became 3i, and went into doing something with a slightly different focus, but our research is very much informed by historical awareness. Indeed, Anthony Seldon has been helping us from the history point of view.

We're looking at international policy approaches to this, too. But you are absolutely right that this is very much grounded in the kind of thinking started by ICFC, which managed to address it from very much a local patient commercial approach.

**Lord Livingston of Parkhead:** And KfW in Germany as well.

***Rebecca Lowe:*** We have also looked at that. It is very hard to take a culture from one place to another, but there is certainly a lot we can learn, particularly from the decentralised nature and from working together. Part of the point about ICFC and BGF is having banks as shareholders and a role for the banks to think in an innovative way, with buy-in across the country, and the provision of awareness as well as financial help.

We are very much focused on that. It is making people aware of their options as well as ensuring that they are able to access those options. That is a very good point; thank you.

**Viscount Chandos:** Along the same lines, since the Macmillan report, but most specifically in the last 30 years, an avalanche of money has gone into private equity globally. Is there still a gap and, if so, why, and how can it be addressed in a way that the private equity/venture capital/growth equity players are not choosing to?

***Rebecca Lowe:*** This is a great question. Part of it is making a distinction between growth equity and private equity and venture capital. We believe you can note a difference here. It is about the patient nature of the investment. There are supply and demand side issues. One thing I would note that we are going to be bringing out in some of our research that we did alongside PwC is a lack of awareness, particularly among growing businesses, of the advantages of patient capital. A lot of them are nervous about growth and nervous about either taking on extended debt or taking on equity in the sense of giving away control of their business.

The mechanism we have at BGF enables us to have this evergreen balance sheet—our shareholders are the main banks—and allows us to take a patient approach. Again, this is different from the funding approach that might be taken in the much shorter term. We want to increase awareness about the advantage of patient capital and unlock some sources that would be appropriate for investing in the growth economy, because, obviously, you have a lot of small companies to invest in. If we take a sovereign wealth fund, it is probably not going to invest in the growth company down your street, but if you can put some together in a portfolio you may well find that there are ways for these big sources of capital to access them.

We are very much looking at this in our paper, so not just accessing the vast sums amassing in the DC funds but enabling shareholder capitalism, whereby you would become more aware of your asset and have a sense of ownership in the nation. I see this as a kind of democratising approach, perhaps partly reflecting the approach to access to home ownership in the 1980s. This could have really wide knock-on benefits, not just for the economy but for society more widely.

**The Chair:** May I welcome to the Committee Marcus Scott, who has just joined us? Rebecca Lowe, may I ask you to be a little briefer in your answers? We are running about 10 minutes behind already. Lord Fox wants to ask a quick question.

**Lord Fox:** It is on the £15 billion, which seems both ambitious and modest. It is ambitious as regards getting it together but modest when you look at the huge scale of debt that has been taken on. Where does the £15 billion come from? What were the parameters or criteria you used to come up with that number?

***Rebecca Lowe:*** That is a good question. As I said, we are focusing specifically on growth economy companies, which we see as those having a turnover of between £2.5 million and £100 million. This is focused on these companies specifically—the kind of companies that we invest in in BGF. We have done some research with PwC that shows the persistent level of gap and persistent funding need. As I said, this is exacerbated, as we have seen—and it is evidenced across the 20th century—in times of crisis. It is similar to the figure that various other players in the ecosystem have been putting forward. We will put our full workings in our paper that is coming out soon, and we will ensure that we share that with you.

**The Chair:** We look forward to receiving that.

Q40 **Viscount Chandos:** Are strategic approaches by the Government such as the proposals for Project Birch and Project Defend an effective way to target investment and support? What impact would that strategic initiative have on private sector investment?

***Claire Walker:*** I will answer briefly. I am aware of time.

What we need to see from these overall approaches is not a one-size-fits-all approach. Critically, we need to think about which the right sectors are to do it in and we also need to learn a lot from international examples. France and Germany did a lot of work in the car sector around a similar type of intervention, which was quite successful. We can look at whether this is a debt that is added to the business or whether there is a more positive way of doing it, such as having an equity stake in the business, which would mean that the taxpayer gets the benefit from the business as it grows.

It is a very powerful role for government in making these interventions. We really need to ensure that it is as supportive as possible for the supply chains, which are also very much affected by such interventions, and not focused solely on companies—that there are some recommendations around how they should pay their supply chains and some standards on how they should be treated. It is about one size not fitting all. There is a role to play.

We are very concerned about some sectors where viable businesses are having a really tough time at the moment. It is a welcome approach, but the devil is in the detail on delivery.

**The Chair:** Marcus Scott, do you want to comment on this?

***Marcus Scott:*** Happily, and apologies for being able to join you from only 3.30 pm onwards.

The Project Birch and Project Defend schemes are more about political and economic policy and which sectors to promote versus which sectors to leave to shrink and perhaps, ultimately, let disappear. They are political decisions.

My understanding of the two schemes is they are highly targeted around individual companies. That will certainly complement the strategic direction of those industries that are considered to be the future of the economy.

I guess the problem is that companies that are picked as national champions have often in the past become inefficient and monopolistic, so care is needed with that. It will require an arm's-length decision so it does not stifle innovation and create barriers that stop new, more dynamic businesses from feeding and growing.

Q41 **Lord Fox:** This question is to Claire Walker. Clearly, there are lots of government measures that are shutting businesses down and limiting businesses. You have made proposals for increased grant support for businesses that have been forced to close by government policy or local lockdowns. Will you elaborate on such a scheme, how it would be administered and on which businesses it would be focused?

***Claire Walker:*** This is an area where the chambers have really come together and made a call for action. It is worth flagging that since our evidence went in there has been some response from the Government and a small local lockdown scheme has been announced. I want to say BCC very much feels this has not gone far enough. It is very difficult for business to be eligible for that, even though we have a fifth of the country in a local lockdown scenario.

The criteria are incredibly tight. You have to have been forced to shut down for three weeks. The payment is just £1,500 or £1,000, depending on your rateable value. We have established that only a few businesses in Leicester that could not re-open when other businesses could are eligible for this grant. That is a real concern for the chambers of commerce.

We heard today from the Prime Minister about some of the restrictions that are coming in for some sectors. What was disappointing about that announcement was that no further support was deemed necessary. We need to look at this scheme specifically.

The mechanism itself is not wrong; it is the value and the criteria. You have to be completely shut rather than partially restricting your trade or your operations, for example. We would like to see an expansion of that scheme both in scale and as regards those criteria.

**Lord Fox:** Is this centrally administered, is it local authority administered, or something else? To whom do I go if my business is struggling because of lockdown measures?

***Claire Walker:*** The specific scheme that I talked about that needs to be expanded and enhanced is an HMRC scheme. There was also a discretionary grant given through local authorities to some businesses that were struggling. We have heard from members that some local authorities did exceptionally well. They got that out very quickly, with 86% distributed in the first week. We saw from other local authorities that that was not distributed as quickly.

In answer to your question, it depends whether the restrictions are national—which in some cases they are—or they are very localised. If they are very localised, there is a very strong argument that it needs to go through local authorities. If it is a national restriction, I think there is a very strong argument that it needs to be national—

**Lord Fox:** I think you froze there. I do not know if it is just me. I got the point; thank you very much.

**The Chair:** Did you want to add anything, Rebecca Lowe or Marcus Scott?

***Marcus Scott:*** No, thank you.

**The Chair:** I know Baroness Kingsmill was having some connection issues. Are you able to ask your question now?

Q42 **Baroness Kingsmill:** I think I am okay now.

Marcus, what is the rationale for a state-owned entity such as the proposed UK recovery corporation recapitalising bad loans?

***Marcus Scott:*** The Government have become the biggest provider of turnaround finance in the UK economy. As well as the grants, the furlough and the loan schemes, the Government have provided about £40 billion of deferrals for VAT and PAYE, which will need to be repaid over the next 12 months or so.

In addition, as the Prime Minister's announcement today made clear, economic activity may again fall due to further lockdowns and restrictions. It is clear that the recovery is going to take a long while and there is only so much companies can borrow.

**Baroness Kingsmill:** Is this taking the risk away from the banks and placing it on the shoulders of the taxpayer?

***Marcus Scott:*** To be honest, the risk is not on the banks at the moment. Most of these loans are 100% guaranteed. There are 1.2 million loans that are 100% guaranteed by government guarantees.

The real challenge is that the banks do not have the option of bringing in other forms of finance. We need to find longer-term, equity-based methods of financing for these viable businesses, turning some of that debt into equity or shares, finding innovative repayment schemes that allow companies to invest and grow and, ultimately, encouraging private sector investments in those companies.

The banks do not have that option. They provide debt. They do not generally invest in the equity of their lenders. That is the role of asset managers and investments.

The only option currently for banks is to put companies into insolvency procedures to recover the loans.

**Baroness Kingsmill:** There is a substantial amount of corporate debt out there. Does that justify having further state guarantees?

***Marcus Scott:*** The real challenge is what that would achieve. If those state guarantees were just extended for a period, which I know is one of the solutions being suggested, that would cost significant amounts of money to the public purse. Extending the loan repayment period for a year would cost about £1 billion. Only somewhere between 22% to 25% of businesses have taken these out.

The real challenge is what that delay would give. If it provides time for a fully thought-through package that gives SMEs in particular clarity and certainty, it would be good value. The reason for focusing on SMEs in particular is they have the largest volume of these loans, but research has shown that about 80% of people who have been unemployed get back into employment through SMEs, so they are going to be a vital part of the re-employment of the large numbers of people who have already lost their jobs.

If it is just kicking the can down the road, I do not think it would be very good value, because it would just store up failure and increase the cost to the taxpayer. If it is to give time to develop a fully thought-through and clear solution, I think that would be incredibly helpful.

**Lord Stern of Brentford:** Thank you very much for that answer, Mr Scott. When the Government take risk and put money in, do you think that some of their criteria for future development—levelling up and tackling regional unemployment, improving productivity, and the drive to net zero emissions, as they come in and take stakes and look to the longer term for these firms—would be helpful?

***Marcus Scott:*** I think some of them are. It is a delicate balance between having a system that is flexible enough for people to use it and achieving the policy ends that are laid out. We think that there has to be some kind of conditionality. For example, if firms were to pay themselves large dividends and claim they could not repay the loans, there would need to be anti-avoidance mechanisms to ensure that did not happen.

We need anti-avoidance mechanisms and some triggers or conditionality around what investments could be made. For example, if people are reinvesting in machinery, it should be machinery that has better energy usage, and so forth. Measures such as that would make a huge amount of sense, because they would contribute towards the improvement of the capital stock of the country overall. It would just be a question of balancing it and choosing those ones that are very important.

**Lord Stern of Brentford:** I should declare that I am about to become the adviser on climate to NatWest.

**Lord Skidelsky:** I can completely see the case for emergency financing, but witnesses have been making the case for what amounts to long-term interference in the allocation of capital, about which economists have generally been quite reluctant. What are the market failures that would justify a long-term programme of capital investment of the kind you have been talking about?

***Marcus Scott:*** We identified three market distortions or anomalies that exist at the moment and need to be resolved that speak directly to this. The first was, essentially, the volume of equity capital that is directed at SMEs that they could use to provide additional equity is insufficient to meet the recapitalisation need. About £1 billion goes into distress and replacement capital every year, and we are probably talking in excess of £25 billion.

The second one is that the operational capacity to distribute the capital, if it is in equity format, is currently sub-scale and is mostly focused around the M25 region. About 50% of the deals in private equity are done within the M25 region, but about 80% of the value.

The third aspect is where the debt is covered by government guarantees. It cannot be refinanced at the moment if re-financing triggers the loss of the guarantee protection.

I guess there were those specific anomalies we had identified. What also needs to be said is that the interference, if you like, in the economy, has already been done. These guarantees exist. They are underwritten by the Government. It is not as if you are talking about the Government taking on a role in the economy that they do not already have. They already have these guarantees in place for 100% of the bounce-back loans and for 80% of the CBILS loans.

Q43 **Lord Livingston of Parkhead:** I think this question is best to Claire Walker. We have already talked about supporting companies that are struggling, but there are a number of companies that are either viable or indeed growing, and they have been helped in some ways by the changes in society with Covid. What measures should be put in place to help these companies recruit employees? We may well have a mismatch between people looking for jobs and companies looking for people where skills or availability or knowledge is a gap.

***Claire Walker:*** I think we know there is a mixed picture out there. Some industries we have talked about have done very badly and some industries are doing well.

We have also seen a huge uptake of the furlough scheme. The Committee does not need me to remind it what proportion of businesses have taken that up. Our research suggests that about one-third of businesses are going to look to reduce staff, so we need to reduce the cost of employment.

We believe there are two ways of doing that to incentivise companies to keep jobs on. The first one is around increasing the threshold for when you start contributing to national insurance. That would take it from about £8,500 to about £12,000, and, if that were introduced, that is a per-person saving per company of about £500 per job, so a significant saving.

The other one to look at is the overall threshold. At the moment it is £4,000 for a company. If you took that up to £20,000, we believe that would have quite a significant effect in encouraging people to employ.

Lastly, we were running a Workplace Training Development Commission before Covid hit. We have done an interim report following the Covid situation.

Many things could be done to use existing frameworks—for example, turning the apprenticeship levy into a training levy, enabling more flexibility for firms in retraining some individuals or using their skills in a different way. There are many other ways we can do that, but that is one mechanism that would be really helpful for firms.

**Lord Livingston of Parkhead:** There are a lot of vacancies in certain sectors, ranging from agriculture to the care sector, that they struggle to fill. I know that some of the entities are not within the chamber of commerce’s remit, but do you have any views or thoughts about how we better align people looking for jobs and jobs looking for people?

***Claire Walker:*** We have quite a lot of agriculture within our membership, but I think it is useful to remember that at the moment circumstances are not normal. Many people are still scared to go outside or are worried about the pandemic. I think some sectors can benefit.

Some sectors are going to be hard hit for a while, aviation being a really good example. We have a chance to push forward, being a global centre for some of the technology around this, but at the moment that is not where people are going to invest. However, we could use some of those skills in more positive ways such as in net zero and keep them within the country and keep the focus. That is where I would be looking: which sectors you can convert and keep up a base of skill to enable us to come back when those sectors rebound.

**The Chair:** What estimates have you made of the costs of those items you have mentioned, starting with the national insurance threshold?

***Claire Walker:*** The national insurance threshold would be £500 per job or £13 billion in total. Our suggestion is that would be for an 18-month period with a taper at the end.

The expansion of the employment allowance would be about a £7 billion intervention. It is sizeable and not insignificant, but if we are going to encourage jobs and job creation, or keep people in jobs, those would be really helpful.

Q44 **Lord Monks:** The emphasis so far has been on propping up companies and jobs through the crisis. My question touches on points that many of you have made in some of your answers already, but perhaps each of you could sharply indicate which key policies you would put in place to pivot from sustaining and financially supporting companies to be able to get through the crisis towards a much more aggressive path to growth and recovery. The key points from each of you would be most interesting to me.

**Rebecca Lowe:** As I have already intimated, I am very focused on equity and recognition of the need for access to equity finance. As I said, this has been recognised as a persistent shortfall. We discussed the Macmillan gap identified in the 1930s, and I think this pertains to Lord Skidelsky's point about market failure. There are insufficient sources of capital for these kinds of company coming through the market. There are also artificial barriers to access and a lack of awareness. There is a role for the state, not by mass intervention in capital markets, but, rather, in liberalising regulations to allow sources of capital to be unlocked, and convening and incentivising where necessary.

What we are calling for is very much a private sector-led initiative. We think that the failure to address this equity shortfall, particularly at the moment, could be particularly disastrous, not just for innovative small local businesses and the knock-on effect in local areas as regards growth and employment, but for the future flexibility and strength of the UK economy. We have a real opportunity now to address this at a time when this shortfall has been seriously exacerbated by Covid.

We need a focus on the lack of equity provision. We think that what we believe to be a market failure, exacerbated by some artificial barriers, should be addressed urgently.

***Claire Walker:*** One area we are particularly interested in, which I think meets that brief, is the extension and the widening of the annual investment allowance. It is expected to run out in the next budget cycle, but we could extend that for another two years.

We also need to look at allowing businesses to use it for things such as training and capital expenditure, and for changes they have had to make through the coronavirus pandemic. That would be a really positive way of ensuring that when companies invest they see a benefit through government schemes. Our estimate is about £0.6 billion to extend that for an 18-month period.

***Marcus Scott:*** I would point to three key things. The first is that the loan schemes that have been put forward by the Government have been incredibly popular, and therefore probably very effective, judging by the numbers of people taking them up. Those now need to be converted into a longer-term tax obligation administered by an organisation but repaid through the tax system, in some kind of means-tested way.

Secondly, we need to find a way to get from the loans through to some kinds of capital instruments. The second recommendation would be converting some of those government guaranteed loans into what is known as subordinated debt or preferred share agreements. The purpose of those is that they are long term in nature and non-voting and, therefore, they do not lead to the business owner or founder losing control of their business.

Thirdly, I would totally agree with Rebecca about the need for equity and growth shares. That is the final step in this process: a mixture of instruments to provide growth capital to rebuild businesses' cash reserves and allow them to invest so that they can grow.

**Baroness Bowles of Berkhamsted:** May I ask one quick question to Rebecca, or perhaps Marcus? You mentioned that you needed some changes to regulation. Apart from Solvency II, what are those, because I can see some government resistance there perhaps?

***Rebecca Lowe:*** I think Solvency II would be complicated. There are international points to be taken into account. One thing we are particularly interested in is access to the DC pension funds. As you know, the Government have promised many times that there should be opportunities for pension fund holders to invest in growth economy companies and other opportunities that are currently not allowed. I think it is fair to say there is consensus across the ecosystem, from the British Business Bank to NEST, that this will not happen unless there is a change to the charge cap. Certainly, we have argued previously about changing it to exclude performance fees from the charge cap for relevant growth equity and VC investments in the form of an immediate carve-out.

We have detailed this in a submission to consultations. It is also going to be in our upcoming paper. This immediate carve-out could be certified by the BBB and BPC, as they currently do for the growth equity funds that they back. We believe this is a small but very meaningful regulatory change that could be made and could have a vast impact, not only on the small businesses that would have access to capital but on pension fund holders, who would be enabled to have a sense of agency, a sense of taking back control, and a sense of involvement in their local areas, too, which I think would resonate quite nicely with some of the messages at the moment.

**Baroness Bowles of Berkhamsted:** I do not quite see how it fits in with the pension regulator's consultation, but perhaps that is a fight for another day.

**The Chair:** May I ask the last question of Marcus Scott? This Committee looked at the student finance scheme, which you have compared to the scheme you are thinking of with a kind of repayment basis. There were a number of recommendations, one of which has been implemented. The Treasury was accepting the interest payment as income in year and the accounting has been changed. We discovered that in cash terms there would be an enormous accumulated debt. I think from memory it was more than £1 trillion. Do you really think you should be touting the student loan scheme as a parallel scheme to be considered?

***Marcus Scott:*** I take your point that there have been some well-documented issues with the student loan scheme that mean that a significant amount of it is likely to be written off. In the report we have suggested a number of different mechanisms that would allow this: first, the interest rates and, secondly, the period over which it is repaid, which would make this significantly different.

The only reason for referring to it as a kind of student loan scheme is that is the easiest way to understand a deferred payment over a period and some contingent tax obligation. I take your point that it would need to be structured in such a way that it did not have the same issues as the student loan scheme. We have tried to address that by ensuring that the term is more sensible and that an increasing coupon rate would encourage earlier payment.

**The Chair:** If you have not already done so, would you send us a note on how you see that working?

***Marcus Scott:*** Absolutely.

**The Chair:** I am sorry that we have been so pressed for time. I am most grateful to our witnesses for answering all our questions, which I appreciate were not easy to deal with in a very short space of time. That has been extremely helpful. We are also very grateful for the written evidence we have received.