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Small Business Service (SBS) and SME Finance

Adrian Piper
*Investment Directorate, Small
Business Service*

Small Business Service (SBS)

The Small Business Service (SBS) was formally launched on 3 April 2000 and is the sole government agency responsible for business support in England. Its goal is to build an enterprise society in which all small businesses thrive and achieve their potential. The SBS provides business support, advice and access to appropriate expertise through the Business Link network. It also manages a number of national services.

Role of SBS Investment Directorate

The role of the SBS Investment Directorate is to identify any market weaknesses in the provision of finance to SMEs and to decide whether and how these might be addressed.

Small Business Investment Taskforce (SBIT)

The 2000 Budget report announced the creation of a Small Business Investment Taskforce (SBIT) to advise David Irwin, SBS chief executive,

and through him the Government, on how best to stimulate the operation of markets providing finance for SMEs. The SBIT also advises on SME finance issues generally, including how best to intervene in venture capital markets.

Formed in September 2000, with an expected term of three years, the SBIT is made up of 18 members who represent a wide cross section of venture capitalists, 'business angels', micro-finance practitioners, financial and business advisers and banks and other providers of debt finance. All have significant, relevant knowledge and experience, which ensures the credibility of the SBIT within the finance sector and associated industries. The SBIT chairman is Sir David Cooksey.

Smart

The Smart scheme in England provides grants to help individuals and small businesses research and develop technologically innovative products and processes, or to buy external consultancy to improve their use and exploitation of technology. The scheme offers support under five elements:

- Technology reviews help a business assess its use of technology against best practice in the sector. A grant up to a maximum of £2,500 is available to cover external review costs if a business expends the equivalent of the grant in terms of its own effort. Projects must involve at least one day's paid consultancy.
- Technology studies for an in-depth look at a business's use of technology help it to identify technological opportunities that may lead to innovative products and processes. A grant of 75 per cent of external study costs, up to a maximum £5,000, is available if the business expends the equivalent of the study costs in terms of its own effort. Projects must involve more than one day's paid consultancy.
- Micro project awards are 50 per cent of eligible costs, up to a maximum grant of £10,000, for the development of simple, low-cost prototypes of new products or processes that involve technological advance and/or novelty. The minimum project size supported is £5,000.
- Feasibility study awards are 75 per cent of eligible project costs, up to a maximum grant of £45,000, for a technical and commercial feasibility study into highly innovative technology. The minimum project size supported is £30,000.

- Development project awards are 30 per cent of eligible project costs, up to a maximum grant of £150,000 (including any grant received for a feasibility study), for the development up to pre-production prototype stage of a new product or process that involves a significant technological advance. The minimum project size supported is £60,000. (A very small number of exceptional development projects may receive up to £450,000 at a negotiable rate not exceeding 30 per cent.)

For a technology review, technology study or development project, applicants must have fewer than 250 employees; for a feasibility study, fewer than 50 employees; for a micro project, fewer than 10 employees.

Debt finance

The banks are by far the most important source of external finance for SMEs in the United Kingdom and are likely to continue to be so. The majority of bank finance consists of term lending and overdrafts, although recent years have seen an increase in other bank products, such as asset-based finance and factored debt. However, the banks continue to place a heavy reliance on security for lending. This, in itself, creates a market gap weakness affecting those businesses that have no security to offer.

Small Firms Loan Guarantee Scheme (SFLGS)

The Small Firms Loan Guarantee Scheme (SFLGS) offers guarantees on loans to small firms with viable business proposals that are unable to obtain conventional finance because they lack security to offer against a loan. By providing a guarantee against default, the scheme encourages lenders to lend where they would not otherwise do so.

Loans over periods of between two and ten years are provided by participating banks and other financial institutions that take responsibility for commercial decisions affecting borrowers. For established businesses that have been trading for two years or more at the time of application, the SBS provides an 85 per cent guarantee on loans of up to £250,000. For other businesses, including start-ups, the guarantee is 70 per cent on loans of up to £100,000. In return for the guarantee, the borrower pays a premium to the agency. For loans with a fixed rate of interest the premium is 0.5 per cent per year on the outstanding loan amount, while for loans with a variable rate of interest the premium is 1.5 per cent per year on the outstanding loan amount.

Loans of up to £30,000, from some of the approved lenders, are subject to simplified administrative procedures which enable the lender to approve applications without first referring them to the SBS, thus speeding up the lending decision.

Applications are made direct to one of the approved lenders who will consider whether to lend the money, and whether it should be by way of a conventional loan or overdraft or the SFLGS. The lender will apply to the SBS for a guarantee covering 70 per cent or 85 per cent of the loan.

Since the launch of the scheme in June 1981, over 76,000 loans, valued at over £2.7 billion, have been guaranteed.

Equity

Risk, or equity, finance, in a variety of forms and from a range of sources, is an increasingly important source of finance for SMEs in the United Kingdom. While it currently accounts for only a small proportion of total SME financing in the United Kingdom, risk capital plays an important role in financing higher-growth small firms. Since the mid-1990s, there has been substantial growth in the supply of risk capital to enterprises from both formal venture capital funds and informal individual 'business angel' investors.

Venture capital investment in the United Kingdom rose to £1,503 million in 1999 (up from £580 million in 1995) involving some 800 companies. Of this total, £347 million was invested in early stage ventures involving 260 companies.

Business angel investment is also increasing rapidly. Although data on this market is much less comprehensive, the supply of UK business angel investment is estimated at around £500 million per year, from some 18,000 actual and potential business angels, investing in some 3,500 businesses.

However, it is widely accepted that raising equity capital in the amounts appropriate to smaller businesses can be particularly difficult due to the high costs and relatively high risk of such investments.

The SBS is taking forward a number of initiatives aimed at increasing the supply of equity finance to SMEs. These include the setting up of Regional Venture Capital Funds; the creation of a UK High Technology Fund; the stimulation, through the National Business Angels Network (NBAN), of the business angel market and proposals for early growth funding.

Regional Venture Capital Funds

There is a current market weakness in the provision of equity finance in amounts below £500,000 for SMEs with aspirations to grow. The Government is establishing a minimum of nine regionally based, commercial funds that increase the amount of 'equity gap' venture capital available to the SME market. These funds are seeking to:

- increase the amount of equity finance available to growing SMEs, to enable them to realise their growth potential;
- ensure that every region in England has access to a viable regionally based venture capital fund, making equity-based investments in amounts below £500,000 in SMEs; and
- demonstrate to potential investors that robust returns can be made by funds investing in the 'equity gap'.

The Regional Venture Capital Funds are:

- commercially focused;
- managed by experienced fund managers with appropriate FSA authorisations; and
- able to raise significant private-sector investment.

Following state-aids clearance, the Government has announced:

- agreement in principle to invest up to £60 million by the European Investment Bank's venture capital arm, the European Investment Fund;
- seed funding by the Government of up to £80 million;
- indicative targets for each region:
 - (a) £30 million for the North West
 - (b) £20 million for the East of England
 - (c) £30 million for the South East
 - (d) £25 million for the South West
 - (e) £25 million for Yorkshire and Humberside
 - (f) £15 million for the North East
 - (g) £20 million for the West Midlands
 - (h) £20 million for the East Midlands
 - (i) £50 million for London.

UK High Technology Fund

Research continues to emphasise the significance of technology-based businesses for future growth in a modern economy and the difficulties they can face in raising early-stage finance. There has also been a reluctance on the part of UK institutions to invest in venture capital funds focused on early-stage high-technology investments. The UK High Technology Fund is a 'fund of funds' that has been set up to address these issues as follows:

- Westport Private Equity Ltd was appointed to manage the 'fund of funds'.
- The fund manager has exceeded the fundraising target, securing commitments of £106.1 million from private-sector investors alongside government investment of £20 million. The co-investors are institutions that are not currently investing in early-stage high-technology venture capital.
- Westport has already made commitments to invest in underlying funds.
- Investments in sectors being supported by the Fund include software, pharmaceuticals, communications, Internet technologies and biosciences.

National Business Angels Network (NBAN)

Informal investors, or 'business angels', play an important role in providing smaller amounts of risk capital to businesses with growth potential, particularly start-up and early-stage businesses. Recent years have seen a significant increase in the level of business angel activity. However, research shows that there are still insufficient mechanisms to distribute information on investors and investment opportunities.

The SBS is therefore jointly supporting the National Business Angels Network (NBAN), with a number of clearing banks and other sponsoring organisations. NBAN is working with the local Business Angels Networks (BANs), banks, accountants and solicitors to bring the informal investment market to full operation. It is a resource for the whole industry and operates as a national conduit through which any company seeking investment can be put in touch with investors.

The SBS is also supporting the Business Angels Network Association (BANA), an industry-wide trade association that aims to

represent the industry and, more importantly, to spread and develop good practice.

Early growth funding

A new programme of early growth funding is being developed in order to encourage risk funding of start-ups and growth firms. The aim is to facilitate the availability of small amounts of risk capital for innovative and knowledge-intensive businesses, as well as for smaller manufacturers needing fresh investment to pursue new opportunities. The SBS will target businesses seeking to raise up to £50,000 and aims to help 1,000 businesses over the next three years.

Investment readiness

To complement its supply-side interventions and to ensure that SMEs are in a better position to obtain and use equity finance, the SBS is addressing the issue of the 'investment readiness' of smaller, growth businesses. A consultation exercise has been undertaken, the results of which are being used to help draw up bidding guidance for a series of pilot projects involving both the public and private sectors. The SBS aims to build on existing investment readiness activities in order to identify those that are most effective.